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No. 06-43

Supreme Court, U.S.
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In The Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

RESPONDENT SCIENTIFIC-ATLANTA, INC.'S OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Do *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), and Section 10(b) contemplate private claims against secondary actors who make no misstatements or omissions to investors (and who owe no duty), but who are nevertheless alleged to have provided "behind-the-scenes" aid or assistance to the party who actually made the misstatements and omissions to investors?

CORPORATE DISCLOSURE STATEMENT

On February 27, 2006, Scientific-Atlanta, Inc. became a wholly owned subsidiary of Cisco Systems, Inc. Since that date, Scientific-Atlanta, Inc. has had no outstanding stock. No publicly held company owns 10% or more of the stock of Cisco Systems, Inc.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
CORPORATE DISCLOSURE STATEMENT	ii
TABLE OF AUTHORITIES	v
INTRODUCTION	1
STATEMENT OF THE CASE	2
REASONS FOR DENYING THE WRIT	4
I. THE CIRCUIT COURT CORRECTLY FOLLOWED PRIOR DECISIONS ON THE SCOPE OF PRIMARY LIABILITY UNDER SECTION 10(B)	4
A. "Deceptive Conduct" Involves Either A Misstatement Or A Failure To Disclose By One Who Has A Duty To Speak	5
B. "Manipulative" Conduct Refers To Illegal Securities Trading Practices And Not To Business Transactions	11
C. Because S-A's Conduct Was Neither Manipulative Nor Deceptive Under The Act, Petitioner's Claims Are At Most Aiding And Abetting	13
II. PETITIONER'S THEORY OF "SCHEME" LIABILITY FAILS TO SATISFY THE REQUIREMENTS FOR PRIMARY LIABILITY AND DOES NOT SUPPORT THE UNDERLYING PURPOSE OF THE ACT	15
A. S-A's Alleged Conduct Was Not "In Connection With The Purchase Or Sale Of Any [Charter] Security"	15

TABLE OF CONTENTS – Continued

Page

B. Petitioner Cannot Satisfy The Mandatory Requirement Of Reliance 17

C. Expanding The Scope Of Liability As Petitioner Requests Would Not Fulfill The Purpose Of The Act 19

III. THE DECISIONS FROM OTHER COURTS CITED BY PETITIONER DO NOT SUPPORT GRANTING CERTIORARI 20

CONCLUSION 22

APPENDIX ..... App. 1

TABLE OF AUTHORITIES

Page

CASES

Affiliated Ute Citizens of the State of Utah v. United States, 406 U.S. 128 (1972) 6, 7, 16, 19

Anixter v. Home-Stake Prod. Co., 77 F.3d 1215 (10th Cir. 1996) 21

Basic Inc. v. Levinson, 485 U.S. 224 (1988) 18

Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) ..... *passim*

Chiarella v. United States, 445 U.S. 222 (1980) 16

Dinsmore v. Squadron, Ellenoff, Plesant, Sheinfeld & Sorkin, 135 F.3d 837 (2d Cir. 1998) 21

Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005) 18

Dutton v. D&K Healthcare Resources, No. 4:04CV147SNL, 2006 WL 1778863 (E.D. Mo. June 23, 2006) 21

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 5, 12

Fidel v. Farley, 392 F.3d 220 (6th Cir. 2004) 21

In re Bristol-Myers Squibb Sec. Litig., 312 F. Supp. 2d 549 (S.D.N.Y. 2004) 21

In re Dynegy, Inc. Sec. Litig., 339 F. Supp. 2d 804 (S.D. Tex. 2004) 21

In re Livent, Inc. Noteholders Sec. Litig., 174 F. Supp. 2d 144 (S.D.N.Y. 2001) 21

Marine Bank v. Weaver, 455 U.S. 551 (1982) 16

Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) ..... *passim*

TABLE OF AUTHORITIES – Continued

Page

SEC v. U.S. Environmental, Inc., 155 F.3d 107 (2d Cir. 1998) 14, 15

SEC v. Zandford, 238 F.3d 559 (4th Cir. 2001) 10

SEC v. Zandford, 535 U.S. 813 (2002) 9, 10, 16

Shapiro v. Cantor, 123 F.3d 717 (2d Cir. 1997) 21

Simpson v. AOL Time Warner Inc., 452 F.3d 1040 (9th Cir. 2006) 21

Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) 7, 9, 17

Tcherepnin v. Knight, 389 U.S. 332 (1967) 19

United States v. O'Hagan, 521 U.S. 642 (1997) 6, 8, 9, 16

Unterberg Harris Private Equity Partners, L.P. v. Xerox Corp., 995 F. Supp. 437 (S.D.N.Y. 1998) 18

Wright v. Ernst & Young LLP, 152 F.3d 169 (2d Cir. 1998) 21

Ziemba v. Cascade Int'l, Inc., 256 F.3d 1194 (11th Cir. 2001) 21

STATUTES AND RULES

15 U.S.C. § 78j(b) ..... *passim*

17 C.F.R. § 240.10b-5 ..... *passim*

INTRODUCTION

This Court should refuse to grant the requested writ of certiorari. The Eighth Circuit's ruling is squarely grounded in this Court's precedent defining the scope of primary liability under the federal securities laws. (*See infra* at 4-14.) Applying this precedent, the circuit court held that Petitioner's claims were foreclosed as a matter of law. The Petition fails to identify any compelling reason to revisit this decision.

All parties agree that *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994), precludes a plaintiff from bringing a private cause of action for aiding and abetting another party's purported securities law violations. *Central Bank* also held that primary liability exists only where the person or entity accused "employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies . . . , assuming *all* of the requirements for primary liability . . . are met." *Id.* (emphasis in original); *see also id.* at 177.[1] Petitioner's theory of liability violates *Central Bank*.

First, Petitioner seeks to pursue classic aiding and abetting claims under the guise of the new label of

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[1] Petitioner inaccurately suggests that this holding is "dictum." (*See* Pet. at 15.) This rule of law is, however, repeated twice in the opinion. *See Central Bank*, 511 U.S. at 177, 191. Moreover, each time it is discussed, it is clear from the context that the statement is not "dictum," but a repetition of long-established principles. *See, e.g., id.* at 177 ("*As in earlier cases* considering conduct prohibited by § 10(b), *we again conclude* that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act.") (emphasis added).

"scheme liability." Second, Petitioner fails to allege either a "manipulative device" or "a material misstatement (or omission)" as to Scientific-Atlanta, Inc. ("S-A") as required under Section 10(b). (*See infra* at 5-12.) Third, because its claims are aiding and abetting, Petitioner has not and cannot satisfy all of the requirements for primary liability under Section 10(b). (*See infra* at 13-20.) There was, therefore, no error in the lower court's decision to dismiss these claims.

STATEMENT OF THE CASE

Petitioner is a Charter investor who sued Charter and its former officers and directors for primary violations of the federal securities laws. Months later, as an afterthought, Petitioner added to the case S-A – a separate public company that did business with Charter – under an aiding and abetting theory. (*See* Amended Consolidated Class Action Complaint dated August 4, 2003, attached hereto as Appendix ("Resp. App.") at 2, 10.)[2] Petitioner alleged that Charter manipulated its accounting of business transactions with its equipment suppliers: S-A and Motorola, Inc. (*See id.* at 3-4.) Based on this allegation, Petitioner purported to assert a cause of action under Section 10(b) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. § 78j(b), and SEC Rule 10b-5(a)-(c), 17 C.F.R. § 240.10b-5, for aiding and abetting the fraud on

[2] After dismissal, Petitioner sought permission to file a second amended complaint, which was denied as futile by the lower court. *See In re Charter Communications, Inc. Securities Litigation*, 443 F.3d 987, 993 (8th Cir. 2006), attached to the Petition for Certiorari as Appendix A ("Pet. App.") at 11a.

Charter's shareholders, which had allegedly been committed by Charter. (*See id.* at 79-80.)

According to the Complaint, S-A allegedly entered into a marketing support agreement with Charter at Charter's request whereby Charter would pay additional sums for each set-top box purchased from S-A and S-A would return this money to Charter in the form of marketing support for advertising. (*See id.* at 3-4, 31-34.) Along with other disclosures of accounting errors, Charter ultimately announced that it had failed to properly account for this transaction with S-A. (*See id.* at 63-70.) The transaction, if properly accounted for, would have resulted in no net economic benefit to either party. (*See id.* at 32-34.)

The Complaint was based *exclusively* on public statements attributed *only to Charter* regarding *Charter's* financial results. (*See, e.g., id.* at 38-63.) The Complaint did not allege that S-A drafted any of the purported misleading statements, nor was it alleged to have had any involvement in the contents of Charter's public statements, control over their circulation, or the ability or duty to independently verify their accuracy. (*See* Pet. App. at 9a-10a.). Petitioner did not dispute that S-A's accounting treatment for this agreement was proper, nor did Petitioner dispute that it was possible for Charter to have accounted for the agreement properly on its books. (*See* Resp. App. at 33-34.) Moreover, the Complaint did not allege that S-A, a third-party vendor, had any involvement in or control over the internal accounting decisions made by Charter and its outside auditors. The Complaint also did not allege any misstatement or omission by S-A to Charter's shareholders. (*See* Pet. App. at 10a ("[S-A] did not issue any misstatement relied upon by the investing public, nor w[as] [it] under a duty to Charter investors and

analysts to disclose information. . . .").) Indeed, Petitioner abandoned the claim it originally had against S-A for Charter's misstatements under Rule 10b-5(b). (*See* Resp. App. at 80.)

Instead, Petitioner now stresses that its claims against S-A – a supposed scheme "to commit a misstatement" – are based on "conduct," which it argues is covered by subparts (a) and (c) of Rule 10b-5. (*See id.* at 3-4, 80.) Petitioner did not allege, however, that it relied on S-A's alleged "scheme" in making its investment decision. Petitioner alleged only that it relied on Charter's alleged misstatements and omissions in making its investment decision. (*See, e.g., id.* at 79-80.)

REASONS FOR DENYING THE WRIT

I. THE CIRCUIT COURT CORRECTLY FOLLOWED PRIOR DECISIONS ON THE SCOPE OF PRIMARY LIABILITY UNDER SECTION 10(B)

As a threshold matter, Petitioner's request for a writ of certiorari propounds an inaccurate reading of the court of appeals' decision. The Petition incorrectly suggests that the Eighth Circuit held that Section 10(b) is limited "only to misleading statements and omissions." (Pet. at 12.) This is incorrect. The circuit court specifically acknowledged that, in addition to misstatements or omissions, certain types of manipulative trading conduct can also be the basis of Section 10(b) claims. (*See* Pet. App. at 5a.) There are no such allegations against S-A. There are also no allegations of any misstatements or omissions by S-A. Indeed, as the lower court held, the conduct of which S-A now stands accused is not prohibited by the text of Section

10(b). Dismissal was, therefore, appropriate. *See Central Bank*, 511 U.S. at 173.

A. "Deceptive Conduct" Involves Either A Misstatement Or A Failure To Disclose By One Who Has A Duty To Speak.

As the Eighth Circuit recognized, a private plaintiff "'may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b).'" (Pet. App. at 8a (quoting *Central Bank*, 511 U.S. at 173).) Section 10(b) makes it unlawful "'[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance. . . .'" (Pet. App. at 4a (quoting 15 U.S.C. § 78j(b)).) Therefore, to state a claim for primary liability under Section 10(b), Petitioner must show that S-A's alleged conduct constitutes a "manipulative or deceptive device or contrivance" within the meaning of Section 10(b). The Eighth Circuit recognized that this inquiry applies with equal force to any subpart of Rule 10b-5 on which a plaintiff purports to bring its claims. (*See* Pet. App. at 8a.) Section 10(b) expressly requires either deceptive or manipulative conduct, and Rule 10b-5 can be no broader in application than the governing statute that authorized that rule. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) ("[D]espite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b).").

The Eighth Circuit looked to this Court's prior opinions, which have held that "[a] device or contrivance is not 'deceptive,' within the meaning of § 10(b), absent some misstatement or a failure to disclose by one who has a duty to disclose." (Pet. App. at 8a.) The Eighth Circuit

correctly relied on the following three decisions, which evidence this rule of law: *Affiliated Ute Citizens of the State of Utah v. United States*, 406 U.S. 128 (1972); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); and *United States v. O'Hagan*, 521 U.S. 642 (1997).

All of these cases support the circuit court's analysis that where, as here, there is no duty to disclose and no corresponding misrepresentation or omission, there is no deceptive device or contrivance on which a Section 10(b) claim may be based. In each case, the issue of whether a defendant's conduct was "deceptive" turned on the existence (or lack thereof) of a duty to speak and a misstatement or omission. These cases do not support Petitioner's contention that liability for "deceptive" conduct may exist absent an alleged misstatement or omission.

Affiliated Ute. This Court found a cause of action in *Affiliated Ute* because the defendants made material omissions in the face of a duty of disclosure owed to the injured shareholders. *Affiliated Ute*, 406 U.S. at 153 (describing the case as "involving primarily a failure to disclose"). While observing that only subpart (b) of Rule 10b-5 speaks specifically in terms of affirmative misstatements, this Court found that claims were stated under subparts (a) and (c) and were "deceptive" within the meaning of the Act because defendants withheld information where they owed a duty of disclosure:

> These defendants' activities . . . disclose, within the very language of one or the other of those subparagraphs, a 'course of business' or a 'device, scheme or artifice' that operated as fraud upon the Indian sellers. *This is so because the defendants devised a plan and induced the mixed-blood holders of UDC stock to dispose of their*

> *shares without disclosing to them material facts that reasonably could have been expected to influence their decisions to sell. . . .* It is no answer to urge that . . . these defendants may have made no positive representation or recommendation. The defendants may not stand mute. . . . The sellers had a right to know that the defendants were in a position to gain financially from their sales and that their shares were selling for a higher price in [the non-Indian] market.

Id. at 153 (emphasis added and citations omitted).

Santa Fe. In *Santa Fe,* the majority shareholders of a company utilized a "short-form merger" transaction to eliminate the interests of certain minority shareholders. *See* 430 U.S. at 465-66. The minority shareholders opposed the sale and claimed that the majority owners violated Rule 10b-5(a) and (c) by paying an inadequate (low) price for their shares and by obtaining a fraudulent appraisal of their stock to justify the lower price. *Id.* at 467-68.

This Court accepted the finding of the district court that there were no omissions or misstatements in the information about the merger sent to the minority shareholders. *Id.* at 474. It was the absence of omissions or misstatements that set this case apart from other decisions of the Court where liability was found to include "some element of deception." *Id.* at 475.[3] For this reason, the Court concluded that its prior cases "do not support the proposition . . . that a breach of fiduciary duty by

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[3] The Court discussed *Affiliated Ute* and *Superintendent of Insurance,* both of which, as discussed above and *infra,* involved misstatements or omissions that gave rise to the necessary element of deception. *Santa Fe,* 430 U.S. at 475 n.15.

majority stockholders, without any deception, misrepresentation, or nondisclosure, violated the statute and the Rule." *Id.* at 476.

Petitioner makes much of the fact that the Court listed these items in the disjunctive (*see* Pet. at 12), but it overlooks the holding of the case. Without a misrepresentation or omission, the transaction at issue (which the minority shareholders argued was without a "justifiable business purpose") could not form the basis of a securities fraud claim. *Santa Fe*, 430 U.S. at 476.[4] In other words, the Court explicitly refused to expand the scope of liability where to do so would not serve the "fundamental purpose" of the Act, which is to insure full and fair disclosure for buyers and sellers of stock. *Id.* at 477-78. Because there had been full disclosure on the merger terms by one with a duty to disclose, no "deceptive" conduct within the meaning of the Act had been alleged and no claim could lie. *Id.* at 474-76.

O'Hagan. This Court also made clear in *O'Hagan* that "deceptive nondisclosure is essential to the § 10(b) liability at issue" in cases involving trading on non-public information. 521 U.S. at 660. Classic insider trading "qualifies as a 'deceptive device' under § 10(b) . . . because 'a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.'" *Id.* at 652. "That relationship . . . 'gives rise to a duty to disclose [or to abstain from

[4] The Court's finding that defendant's conduct also was not "manipulative" within the meaning of Section 10(b) is discussed *infra* at 11-12.

trading] because of the necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed . . . stockholders.'" *Id.*

Similarly, the "misappropriation theory" adopted in *O'Hagan* – where an outsider to a company trades on nonpublic information – likewise turns on the existence of a duty and a non-disclosure. *See id.* at 652-53. "[T]he misappropriation theory outlaws trading on the basis of nonpublic information by a corporate 'outsider' in breach of a duty owed not to a trading party, but to the source of the information." *Id.* The misappropriators similarly "deal in deception" through nondisclosure, pursuant to which liability under Section 10(b) may attach. *See id.* at 653.

***Superintendent of Insurance* and *Zandford*.** *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), and *SEC v. Zandford*, 535 U.S. 813 (2002), do not assist Petitioner. Those cases involve deceptive conduct in the form of either misstatements or omissions. In *Superintendent of Insurance*, the Court found that a claim under Section 10(b) was stated where a company's board of directors was deceived into authorizing the sale of its stock "by the *misrepresentation* that the proceeds would be exchanged for a certificate of deposit of equal value." 404 U.S. at 167 n.1 (emphasis added).

Similarly, in *Zandford*, a broker had been given a power of attorney that allowed him to execute stock transactions for his clients. 535 U.S. at 817. The broker represented to the clients that he would "conservatively invest" their money and would pursue investment objectives for the "safety of principal and income." *Id.* The broker, however, sold the securities in the account and personally pocketed the proceeds. *Id.*

A cause of action existed under Section 10(b) because "each sale [of stock] was made to further [the broker's] fraudulent scheme [and] each was deceptive because it was neither authorized by, nor disclosed to, the [clients]." *Id.* at 820-21. The clients "were injured as investors through [the broker]'s deceptions" and "were duped into believing [he] would 'conservatively invest' their assets in the stock market and that any transactions made on their behalf would be for their benefit for the 'safety of principal and income.'" *Id.* at 822. The broker was in a position of trust and acted as a fiduciary to his clients. Accordingly, he owed them a duty of disclosure and deceived them by failing to disclose his true intention to use the stock sales proceeds for his personal benefit. *Id.* at 822-23.[5]

As the above discussion indicates, the Eighth Circuit correctly followed this Court's directives as to the type of activity that qualifies as a "deceptive device or contrivance" under the Act.

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[5] Petitioner focuses on the following statement in *Zandford*: "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." (Pet. at 17 (quoting *Zandford*, 535 U.S. at 820).) However, this Court was referring to the lower court's reluctance to find a claim where "[i]t is not even alleged that [the broker] misled [his clients] about the relative merits or value of particular securities." *SEC v. Zandford*, 238 F.3d 559, 564 (4th Cir. 2001). Section 10(b) liability, however, extends to both affirmative misrepresentations as discussed by the lower court and omissions where a duty to speak exists. Indeed, the *Zandford* Court stated that the distinction between affirmative misstatements and omissions is "illusory" where the context is a broker who has a fiduciary duty to his or her clients. 535 U.S. at 823. *Zandford*, thus, does not support the view that "deception" under the Act extends beyond misrepresentations or omissions. Rather, *Zandford* reflects the omissions variety of deceptive conduct previously recognized by this Court.

B. "Manipulative" Conduct Refers To Illegal Securities Trading Practices And Not To Business Transactions.

An alternative basis for a Section 10(b) claim exists if the conduct is "manipulative" under the Act. The Eighth Circuit recognized that this term has been given "the limited contextual meaning ascribed in *Santa Fe*." (Pet. App. at 8a.) "Manipulative" is considered to be "'a term of art' and refers to illegal trading practices such as 'wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.'" (Pet. App. at 5a (quoting *Santa Fe*, 430 U.S. at 476).) In *Santa Fe*, this Court declined to expand the term beyond its commonly accepted usage. Thus, the request to do so here does not justify granting the Petition.

In *Santa Fe*, this Court held that the term "manipulative" as used in Section 10(b) did not extend to the defendant's actions in executing a short-form merger or in obtaining an allegedly fraudulent appraisal to justify a lower buy out price. 430 U.S. at 476-77. The Court found that this business conduct was not the type of manipulative trading activity the securities laws were designed to reach:

> Section 10(b)'s general prohibition of practices deemed by the SEC to be "manipulative" in this technical sense of artificially affecting market activity in order to mislead investors is fully consistent with the fundamental purpose of the 1934 Act "to substitute a philosophy of full disclosure for the philosophy of caveat emptor. . . ." Indeed, nondisclosure is usually essential to the success of a manipulative scheme. No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities

> prices. But we do not think it would have chosen this "term of art" if it had meant to bring within the scope of § 10(b) instances of corporate mismanagement such as this. . . .

Id. (citations omitted).

Ernst & Ernst is also instructive and was cited by the Eighth Circuit. *Ernst* held that the term "manipulative" "is and was virtually a term of art when used in connection with securities markets" referring to "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." 425 U.S. at 199. Petitioner cites to other definitions discussed in *Ernst*, but tellingly avoids the Court's discussion of the word "manipulate." (*See* Pet. at 11-12.) The *Ernst* Court noted that "manipulate" when used in reference to "Exchanges" means "[t]o force (prices) up or down, as by matched orders, wash sales, fictitious reports . . . ; to rig." *Id.* at 199, n.21.[6] This is consistent with the Eighth Circuit's opinion and *Santa Fe*. There was no error in the circuit court's handling of this issue or in the application of precedent as demonstrated above.

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[6] It is important to note that Petitioner cites to portions of the *Ernst* decision that do not reflect the Court's holding, but instead summarize the position of the Securities and Exchange Commission that was rejected by the Court. (*See* Pet. at 12 (citing *Ernst*, 425 U.S. at 212).)

C. Because S-A's Conduct Was Neither Manipulative Nor Deceptive Under The Act, Petitioner's Claims Are At Most Aiding And Abetting.

Petitioner suggests that the court of appeals erred in its application of *Central Bank* – claiming that *Central Bank* did not purport to address what constitutes a claim for primary liability under Section 10(b). (*See* Pet. at 14.) The circuit court's decision that no claim was possible, however, was based on both *Central Bank*'s prohibition against aiding and abetting claims and this Court's prior interpretation of what constitutes deceptive or manipulative devices for purposes of primary liability. (*See* Pet. App. at 8a-10a.) If the conduct of a defendant falls short of this Court's definition of primary liability, the conduct is at most non-actionable aiding and abetting. The court of appeals correctly concluded that "any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5." (*Id.* at 9a.)

Here, it is undisputed that S-A made no statements to Charter shareholders and could not be responsible for any actionable omissions to them, given that it owed no duty to speak to Charter's investors (a fact which Petitioner does not dispute). (*See id.* 9a-10a.) It is similarly without dispute that S-A did not engage in any manipulative trading practices regarding Charter stock that could have affected its market or its prices. (*See id.*) Thus, Petitioner has failed to plead a cognizable claim for primary liability.

Petitioner's theory is based solely on S-A's participation in the marketing support transaction – the only

conduct of S-A alleged in the Complaint. The Complaint, however, concedes that this type of agreement could have been accounted for properly by Charter – as S-A did on its books. Further, Petitioner alleges no efforts by S-A to misrepresent this transaction to Charter's shareholders – it alleges only that *Charter* misrepresented it.[7] Petitioner does not claim that any Charter shareholders were even aware of the transaction. As this Court held in *Central Bank*, "[w]e cannot amend [Section 10(b)] to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute." 511 U.S. at 177-78. Aiding and abetting claims are designed to "reach[] persons who do not engage in the proscribed activities at all, but who give a degree of aid to those who do." *Id.* at 176. Because the only conduct alleged against S-A – an agreement for marketing support – is not proscribed by the statute, the claim asserted is one of aiding and abetting the allegedly prohibited conduct of other parties, which is barred by *Central Bank*. *Id.*[8]

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[7] Petitioner makes additional allegations regarding certain documentation on the marketing support transaction, attempting to create the appearance of a "deceptive" act. (*See* Pet. at 21.) But Petitioner never explains how this conduct supposedly reached or affected Charter shareholders. Petitioner does not allege that any shareholders ever saw these documents or that their contents were disclosed publicly. Moreover, as discussed *infra*, these documents had no relation to the purchase or sale of any Charter securities, and Charter investors did not purport to rely on these documents for purposes of making their investment decisions.

[8] Petitioner's speculation that S-A "knew" Charter intended to use the marketing support agreement to artificially inflate its reported financial results does not save its claims. These allegations confuse "the distinction drawn in *Central Bank* between primary violators and aiders/abettors based on conduct with the separate issue of scienter." *SEC v. U.S. Environmental, Inc.*, 155 F.3d 107, 111 (2d Cir. 1998).

(Continued on following page)

II. PETITIONER'S THEORY OF "SCHEME" LIABILITY FAILS TO SATISFY THE REQUIREMENTS FOR PRIMARY LIABILITY AND DOES NOT SUPPORT THE UNDERLYING PURPOSE OF THE ACT

There can be no claim for primary liability under Section 10(b) unless all of the necessary elements have been met as to each defendant. *Central Bank*, 511 U.S. at 191. However, Petitioner has not pled, *inter alia*, (1) any deceptive or manipulative act committed by S-A, as discussed above, (2) that was in connection with the purchase or sale of Charter stock, and (3) on which Petitioner relied. Petitioner's failure to plead all the well-established and necessary elements of a claim under Section 10(b) provides another basis for denying certiorari.

A. S-A's Alleged Conduct Was Not "In Connection With The Purchase Or Sale Of Any [Charter] Security."

Central Bank observed that Section 10(b) "imposes private civil liability on those who commit a manipulative or deceptive act *in connection with the purchase or sale of securities*." 511 U.S. at 166 (emphasis added); *see also* 15 U.S.C. § 78j. S-A, however, neither bought nor sold Charter securities and is not alleged to have had any connection with the transactions by which Petitioner or other putative class members became investors in Charter. The

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Whether the defendant "was a primary violator rather than an aider and abettor turns on the nature of his acts, not on his state of mind when he performed them." *Id.* Accordingly, conclusory allegations of a shared intent by S-A and Charter to mislead Charter's investors cannot create a cause of action against S-A under the Act.

marketing support agreement involved the sale of digital set-top boxes, not the sale of Charter stock.

A commercial transaction unconnected to the purchase or sale of a security cannot be deemed to fall within Section 10(b) simply because the party standing on the other side of the transaction was a public company whose stock was purchased and sold by investors. Such a result would extend the scope of liability far beyond the text of the statute. Section 10(b) should not be interpreted so broadly as to convert every allegation of common-law fraud that happens to involve securities into a putative Section 10(b) claim. *See, e.g.*, *Zandford*, 535 U.S. at 820; *see also Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982) ("Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud."); *Chiarella v. United States*, 445 U.S. 222, 232 (1980) ("[N]ot every instance of financial unfairness constitutes fraudulent activity under § 10(b).").

All the decisions of this Court on which Petitioner purports to rely demonstrate the importance of the "in connection with" requirement. In each of these cases, the defendant had personally engaged in conduct directly "in connection with the purchase or sale of a security," unlike here. *See, e.g.*, *Zandford*, 535 U.S. at 824-25 (broker *sold customer's securities* without permission and without disclosing intent to misappropriate proceeds); *O'Hagan*, 521 U.S. at 659 (holding that secretly using misappropriated confidential information *for trading purposes* violated Section 10(b)); *Affiliated Ute*, 406 U.S. at 151-53 (finding that defendants could be liable under Rule 10b-5(a) and (c) because they *executed plaintiffs' stock sales* on which they stood to personally profit and were also *purchasers of the same stock* on their own behalf and on behalf of other

accounts they solicited, set up, and on which they received commissions); *Superintendent of Ins.*, 404 U.S. at 9-10 (misleading investor *into selling treasury bonds* on erroneous belief that it would receive proceeds from the sale). The marketing support agreement between S-A and Charter is not, and has not been alleged to be, "in connection with the purchase or sale" of Charter stock. This missing element is an independent basis for the correctness of the circuit court decision and denial of the Petition.

B. Petitioner Cannot Satisfy The Mandatory Requirement Of Reliance.

Petitioner's theory of scheme liability also fails because it cannot plead reliance or transaction causation. The inability to demonstrate reliance is one of the reasons why aiding and abetting claims cannot be allowed. *Central Bank*, 511 U.S. at 180. Under *Central Bank*, primary liability under Section 10(b) requires "a manipulative device or . . . a material misstatement (or omission) *on which a purchaser or seller of securities relies. . . .*" 511 U.S. at 191 (emphasis added).

Petitioner has not pled that it relied on anything S-A said or did. In fact, Petitioner shareholder does not dispute that it relied solely on the public statements of Charter and the purported effect of those statements on Charter's stock price. This is fatal to its claims. Under *Central Bank*, there is no exception to the requirement of pleading reliance simply because a plaintiff chooses to sue multiple defendants whom it claims participated together in an alleged "scheme." Petitioner must plead individual reliance or be able to avail itself of a judicially recognized presumption of reliance, such as the "fraud-on-the-market"

theory from *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). The Petition makes reference to neither.

In any event, under the fraud-on-the-market theory, only *publicly available information and misleading statements* released to the market by Charter could have influenced the price of Charter's securities. *See id.* at 247 ("Because most publicly available information is reflected in market price, an investor's reliance on *any public material misrepresentations*, therefore, may be presumed for purposes of a Rule 10b-5 action.") (emphasis added). There were no statements issued to the market by S-A regarding the subject transaction or Charter. Thus, the essential element of reliance does not and cannot exist here, which requires dismissal under *Central Bank*. *See* 511 U.S. at 180 ("Allowing plaintiffs to circumvent the reliance requirement [through aiding and abetting claims] would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.").[9]

[9] Petitioner's theory of scheme liability also fails because it cannot allege sufficient facts to show loss causation, another mandatory requirement of Section 10(b). *See generally Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). Loss causation "cannot be found if an intervening cause was responsible for the plaintiff's economic loss." *Unterberg Harris Private Equity Partners, L.P. v. Xerox Corp.*, 995 F. Supp. 437, 441 (S.D.N.Y. 1998). Petitioner alleges no facts to show that the marketing support transaction itself (and not Charter's intervening alleged improper accounting) caused any of the purported inflation of the price of Charter stock. Had Charter accounted for the transaction properly, there would have been no purported artificial inflation, and Petitioner concedes that such transactions could be accounted for properly.

C. Expanding The Scope of Liability As Petitioner Requests Would Not Fulfill The Purpose Of The Act.

As prior precedent from this Court demonstrates, the goal of the Act is to promote disclosure. *See, e.g., Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967) (noting that "[o]ne of [the Act's] central purposes is to protect investors through the requirement of full disclosure by issuers of securities, ..."); *see also Affiliated Ute*, 406 U.S. at 151 (the Act "embrace[s] a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor. . . .'"). "[A] private cause of action under the antifraud provisions of the . . . Act should not be implied where it is 'unnecessary to ensure the fulfillment of Congress's purposes' in adopting that Act." *Santa Fe*, 430 U.S. at 477.

The recognition of a cause of action here would not promote this essential goal of disclosure. The party which Petitioner contends should have disclosed the "true" facts is Charter. The proposed defendant S-A is a separate entity altogether which owed the Charter shareholders no disclosure obligations. S-A is also not alleged to have had the ability to police the public statements of Charter or to have been involved in their preparation or circulation.

Moreover, to recognize the cause of action sought by Petitioner would add uncertainty to this area of the law. As this Court found in *Central Bank*, "'[s]uch a shifting and highly fact-oriented disposition of the issue of who may [be liable for] a damages claim for violation of Rule 10b-5' is not a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions.'" 511 U.S. at 188 (citations omitted). Concerns over expanding the scope of potential liability too broadly are particularly

relevant in securities cases. "'[L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general.'" *Id.* at 189 (citations omitted).

In this respect, it is ironic that Petitioner suggests certiorari should be granted because Section 10(b) liability presents "'an area that demands certainty and predictability, ...'" (Pet. at 10 (citing *Central Bank*, 511 U.S. at 188).) It would, however, have this Court articulate a new rule of law that would extend potential liability to parties who owe no current duty under the law. The Eighth Circuit acknowledged the dangers associated with such a view, noting that it was for Congress to first decide such matters. (*See* Pet. App. at 10a (recognizing that Petitioner's theory of liability "would introduce potentially far-reaching duties and uncertainties for those engaged in day-to-day business dealings.").) It is not, therefore, "critically important" to grant certiorari here to change the law in a direction that would be contrary to the Act and that has been rejected in prior decisions of this Court.

III. THE DECISIONS FROM OTHER COURTS CITED BY PETITIONER DO NOT SUPPORT GRANTING CERTIORARI

The *Charter* decision is consistent with the Act and this Court's prior decisions. Petitioner's certiorari request asks this Court to depart from prior precedent and embrace the decisions of certain district courts and a decision

of the Ninth Circuit that purport to adopt new standards of liability. (*See, e.g.*, Pet. at 18-20.)[10]

The cases on which Petitioner relies are not persuasive for the reasons outlined above. They are in conflict with this Court's prior rulings, are inconsistent with the text and purpose of Section 10(b), and authorize recovery where all the mandatory requirements of a Section 10(b) claim cannot be satisfied. They do not, therefore, provide a basis for granting the Petition.

The following decisions from courts, other than this Court, support the Eighth Circuit's interpretation of Section 10(b) and *Central Bank*: *Fidel v. Farley*, 392 F.3d 220 (6th Cir. 2004); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194 (11th Cir. 2001); *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998); *Dinsmore v. Squadron, Ellenoff, Plesant, Sheinfeld & Sorkin*, 135 F.3d 837 (2d Cir. 1998); *Shapiro v. Cantor*, 123 F.3d 717 (2d Cir. 1997); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215 (10th Cir. 1996); *Dutton v. D&K Healthcare Resources*, No. 4:04CV147SNL, 2006 WL 1778863 (E.D. Mo. June 23, 2006); *In re Dynegy, Inc. Sec. Litig.*, 339 F. Supp. 2d 804 (S.D. Tex. 2004); *In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d 549 (S.D.N.Y. 2004); and *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144 (S.D.N.Y. 2001).

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[10] The Ninth Circuit apparently does not believe that its decision in *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006), is in conflict with *Charter*. *See Simpson*, 452 F.3d at 1050 (citing *Charter* in support of the point that "[p]articipation in a legitimate transaction, which does not have a deceptive purpose or effect, would not allow for a primary violation even if the defendant knew or intended that another party would manipulate the transaction to effectuate a fraud.").

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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October 20, 2006

JURY TRIAL DEMANDED

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

IN RE CHARTER COMMUNICATIONS, INC. SECURITIES LITIGATION	**MDL DOCKET NO. 1506 (CAS) ALL CASES**
STONERIDGE INVESTMENT PARTNERS LLC, Individually and On Behalf of All Others Similarly Situated,	**Consolidated Case No. 4:02-CV-1186 CAS**

Plaintiff,

v.

CHARTER COMMUNICATIONS, INC., PAUL ALLEN, JERALD L. KENT, CARL E. VOGEL, KENT KALKWARF, DAVID G. BARFORD, PAUL E. MARTIN, DAVID L. McCALL, BILL SHREFFLER, CHRIS FENGER, JAMES H. SMITH, III, SCIENTIFIC-ATLANTA, INC., MOTOROLA, INC. and ARTHUR ANDERSEN, LLP,

Defendants.

AMENDED CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATIONS OF FEDERAL SECURITIES LAW

(Filed Aug. 5, 2003)

Lead Plaintiff, by its attorneys, for its Consolidated Class Action Complaint alleges the following upon personal

knowledge as to itself and its own acts, and upon information and belief based upon the investigation of Lead Plaintiff's attorneys as to all other matters. The investigation included the thorough review and analysis of public statements, publicly filed documents of Charter Communications, Inc. ("Charter" or the "Company"), press releases, news articles, and the review and analysis of accounting rules and related literature.

The investigation also included extensive interviews with numerous former Charter employees from offices in virtually all regions in which the Company does business. Such employees include individuals who held varied and diverse positions with the Company: directors of operations and marketing, accounting managers, technical supervisors and customer service representatives. The allegations set forth herein reflect specific and credible information provided by such individuals regarding Charter's ongoing practices, which were often corroborated by multiple employees.

SUMMARY OF ACTION

1. This is a securities class action on behalf of investors who purchased the securities of Charter during the period from November 8, 1999, through July 17, 2002 (the "Class Period"). Lead Plaintiff complains of a fraudulent scheme that injured purchasers of Charter stock during the Class Period.

2. Charter is headquartered in St. Louis, Missouri and purports to be the nation's fourth largest cable operator.

3. From the outset of the Class Period, Defendants portrayed Charter as a booming company which was experiencing a steady internal growth rate of new subscribers (in contrast to new customers from acquired companies), along with increased operating "cash flow" and reduced losses. Indeed, the Company boasted that its 2+% internal growth rate for new customers was the highest of the nation's large cable companies, and that it was likewise a leader in "operating cash flow" growth.

4. In order to maintain this upbeat image, defendants engaged in a pervasive and continuous fraudulent scheme intended to artificially boost the Company's customer base and reported financial results. But for this scheme, Charter would have reported no net increase in customers from internal growth. Moreover, Charter's critical growth rate of operating cash flow was materially inflated during 2001, and was only half the amount publicly reported.

5. Among other things, defendants inflated Charter's internal customer growth rate by deliberately delaying "disconnects" for over 100,000 customers who were no longer paying their bills, or who had advised the Company they wished to terminate their service.

6. In addition, defendants materially inflated Charter's operating cash flow by improperly capitalizing labor-related and other costs that should have been expensed. Defendants also improperly recognized up front all revenues received in connection with the launch of new programming channels, rather than spreading such revenues over the term of the programming contract.

7. As a further device to inflate the Company's reported performance, Charter entered into kickback

arrangements with defendants Scientific-Atlanta, Inc. ("Scientific-Atlanta") and Motorola, Inc. ("Motorola'), the suppliers of key components for use by Charter's customers. During the fourth quarter of 2000, Charter agreed to pay Scientific-Atlanta and Motorola an additional $17 million for digital set-top boxes used by cable customers above and beyond the amounts ordinarily charged for such components. In exchange for these defendants agreed to kickback all those additional monies to Charter in the form of "advertising fees." Charter booked the payments to Scientific-Atlanta and Motorola as capital expenditures (which were then depreciated over the life of the equipment, and thus not included in Charter's reported "operating cash flow" figures), while it improperly booked the "advertising fees" received from Scientific-Atlanta and Motorola as revenue (rather than a direct set-off against costs), thereby inflating revenues and cash flow.

8. As a result of these fraudulent accounting practices, Charter's reported revenues and operating cash flow were materially inflated, and its losses were materially understated.

9. Defendants engaged in this multi-prong scheme for one purpose – to "meet the numbers" that Wall Street had projected for Charter, and thereby boost the price of the Company's stock, enabling it to acquire other companies using its inflated stock as currency.

10. As a result of these illegal practices, Charter's stock price rose to an artificial Class Period high of $26.31 per share.

11. On July 17, 2002, analysts voiced skepticism regarding some of Charter's accounting practices. Shortly thereafter, on August 16, 2002, the Company revealed that

a federal grand jury was conducting a criminal probe of Charter's accounting for capital expenses, and its inflating the number of customer accounts. This followed the write-off of 145,000 customers by Charter earlier in the year, effectively wiping out all the previously reported internal subscriber growth.

12. On October 22, 2002, the Company announced that, due to the pendency of the Grand Jury proceedings, it was placing its Executive Vice President and Chief Operating Officer, defendant David G. Barford, on paid leave.

13. Subsequently, on December 23, 2002, the Company announced that both Barford and the Company's Chief Financial Officer, defendant Kent D. Kalkwarf, had been fired following an internal investigation of various matters, including those related to the Grand Jury investigation. The Company also stated that its books and records for the years 2000 and 2001 were being reaudited by the Company's new accountants, KPMG LLP, who had replaced defendant Arthur Andersen LLP.

14. On February 10, 2003, it was publicly disclosed that the Grand Jury investigating Charter had subpoenaed records from Scientific-Atlanta.

15. On April 2, 2003, Charter announced its "preliminary" restatement of reported results for 2000 and 2001, as well as the first three quarters of 2002. The Company acknowledged for the first time that its "operating cash flow," otherwise known as earnings before interest, taxes, depreciation and amortization ("EBITDA"), had been inflated for 2001 by 19.5% ($292 million), and for 2000 by 14.5% ($195 million). Most significantly, the Company acknowledged for the first time that whereas it

had reported operating cash flow had grown 12.5% during 2001 compared to 2000, in fact, such growth had been only half that amount.

16. The foregoing fraudulent practices materially inflated Charter's stock price. Increasing skepticism regarding the accuracy of the Company's prior disclosures caused Charter's stock price to fall from over $20 in late 2001, to less than $10 by July 2002. Following the disclosure of the Grand Jury Investigation, the price plummeted, falling to a 52-week low of $0.76 on October 11, 2002, down approximately 97% from its Class Period high.

17. On July 24, 2003, the Grand Jury returned an indictment ("Indictment") against four of the defendants – David G. Barford, Kent D. Kalkwarf, David L. McCall and James H, Smith, III, charging that they "knowingly devised and intended to devise a scheme to defraud investors in Charter securities." The Indictment focused specifically on deliberate inflation of Charter's customer count, and the kickbacks from Scientific-Atlanta and Motorola. On July 25, 2003, defendant McCall entered a guilty plea, signed a Plea Agreement, Guidelines Recommendations and Stipulations ("Plea Agreement"), and acknowledged in Court that he had been instructed to inflate subscriber counts.

JURISDICTION AND VENUE

18. This Court has jurisdiction over this action pursuant to Section 27 of the Securities Exchange Act of 1934 (the "1934 Act"), 28 U.S.C. §§ 1331 and 1337. The claims asserted herein arise under Section 11 of the Securities Act of 1933 (the "1933 Securities Act"), 15 U.S.C. § 77 (k); Section 12 of the 1933 Securities Act, 15

U.S.C. § 77(l); Section 15 of the Securities Act, 15 U.S.C. § 77(o); Sections 10(b) and 20(a) of the 1934 Act, 15 U.S.C. §§ 78j(b) and 78t(a); and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder by the SEC.

19. Venue is proper in this District pursuant to Section 22 of the 1933 Act, 15 U.S.C. § 77(v); Section 27 of the 1934 Act, 15 U.S.C. § 78aa; and, 28 U.S.C. § 1391(b). Many of the Charter Related Defendants reside in this District. Many of the acts giving rise to the violations complained of, including the dissemination of false and misleading public statements and financial information, occurred in this District.

20. In connection with the wrongs alleged herein, Defendants used the instrumentalities of interstate commerce, including the United States mails, interstate wire and telephone facilities, and the facilities of the national securities markets.

THE PARTIES

21. Lead Plaintiff StoneRidge Investment Partners LLC purchased shares of Charter common stock in the Company's Initial Public Offering on November 8, 1999, and during the Class Period, as set forth in its previously filed Certification, and was damaged thereby.

22. Defendant Charter is a Delaware corporation whose headquarters are located at 12405 Powerscourt Drive, St. Louis, Missouri 63131. Charter is a cable operator that provides video, data, interactive and private business network services to purportedly seven million customers in forty States through the Company's broadband network of coaxial and fiber-optic cable. The Company

offers traditional analog cable as well as digital television services, along with an array of advanced products and services such as high-speed Internet access, interactive video programming and video-on-demand. By the end of the Class Period, Charter's customer base was approximately 7 million. As of May 24, 2002, Charter had 294,647,000 shares of common stock outstanding. Charter's shares trade on the Nasdaq National Market under the symbol "CHTR."

23. Defendant Paul Allen ("Allen") is the founder, Chairman and controlling shareholder of Charter. Defendant Allen owns 56% of Charter's outstanding shares through a holding company, Vulcan Ventures Incorporated, which is entitled to all of Charter's tax losses.

24. Defendant Jerald L. Kent ("Kent") was the President, Chief Executive Officer and director of Charter from July 1999 through the time of his resignation, which was effective as of September 28, 2001. Kent had previously served as Chief Financial Officer of Charter Investment, Inc., a predecessor to, and affiliate of, the Company. From 1979 to 1983 Kent worked in the Tax Division of Arthur Anderson.

25. Defendant Carl E. Vogel ("Vogel") became Charter's President and Chief Executive Officer, and a director of the Company, in October 2001.

26. Defendant Kent Kalkwarf ("Kalkwarf") was, during the Class Period, Executive Vice President and Chief Financial Officer ("CFO") of Charter. Kalkwarf was formerly a partner of defendant Arthur Andersen LLP. Defendant Kalkwarf has been indicted by the Grand Jury investigating Charter's misconduct.

27. Defendant David G. Barford ("Barford") was, during the Class Period, Executive Vice President and Chief Operating Officer of Charter. Defendant Barford has been indicted by the Grand Jury investigating Charter's misconduct.

28. Defendant Paul E. Martin ("Martin") was, during the Class Period, Senior Vice President and Corporate Controller (Principal Accounting Officer).

29. Defendant David L. McCall ("McCall") was, during the Class Period, Senior Vice President of Operations for Charter's Eastern Division. In addition to his salary, McCall was a member of a partnership that received $177,600 in 2001 for office space leased to Charter. In addition, in 2001, Charter paid $571,533 to a construction company controlled by McCall's brother and $462,071 to a construction company controlled by McCall's son. Defendant McCall has been indicted by the Grand Jury investigating Charter's misconduct, and has entered a guilty plea.

30. Defendant William Shreffler ("Shreffler") was, during the Class Period. Senior Vice President of Operations for Charter's MidWest Division.

31. Defendant Chris Fenger ("Fenger") was, during a portion of the Class Period, Senior Vice President of operations for Charter's Western Division.

32. Defendant James H. Smith, III ("Smith") was, during a portion of the Class Period, Senior Vice-President of Operations in charge of Charter's Western Division. Defendant Smith has been indicted by the Grand Jury investigating Charter's misconduct.

33. Defendants Allen, Kent, Vogel, Kalkwarf, Barford, Martin, McCall, Shreffler, Fenger and Smith are sometimes referred to herein as the "Individual Defendants." Collectively with Charter, the Individual Defendants are referred to as the "Charter Related Defendants."

34. Defendant Scientific-Atlanta, Inc. ("Scientific-Atlanta") is based in Atlanta, Georgia, and is one of the nation's leading manufacturers of electronic equipment, including digital set-top boxes for use in the cable industry. A digital set-top box is equipment that is placed on a subscriber's television enabling it to receive and view digital television. Charter purchases this equipment and supplies them to its customers so they can view Charter's cable television programs.

35. Motorola, Inc. ("Motorola") is based in Schaumburg, Illinois, and is one of the nation's leading manufacturers of electronic equipment, including digital set-top boxes for use in the cable industry.

36. Defendant Arthur Andersen LLP ("Arthur Andersen") is an accounting firm headquartered in Chicago, Illinois, which served as Charter's independent auditor during the Class Period.

BACKGROUND

Charter's Corporate Structure

37. During the Class Period, Charter was headquartered in St. Louis, Missouri, where all statements issued to investors were prepared and disseminated. Through 2000, Charter was divided into two operating "divisions," the Eastern and Western Divisions. Defendant McCall was the Senior Vice President of Operations for the Eastern

Division. In 2001, the Western Division was divided into the (i) Midwest and (ii) Western Divisions, at which time it was headed by Senior Vice Presidents, defendants (i) William Shreffler and (ii) Chris Fenger and James Smith, III. Each of the Senior Vice Presidents for the Divisions were featured in Charter's Annual Reports. Within each of the Divisions there were several "Operating Regions," of which there were 10-12 altogether.

38. The Divisions, Regions, and individual offices of Charter were linked through two centralized computer systems, known as "Cable Data" and "CSG," that tracked all customer account and billing information.

39. Accounting personnel at Charter's Western Division office, located in Denver Colorado, collected and compiled financial data from the local and regional offices and forwarded the results to corporate accounting at Charter's headquarters in St. Louis. Defendant Kalkwarf, the Chief Financial Officer and defendant Martin, the Vice President of Accounting, supervised the final compilation of Charter's financial numbers in St. Louis.

The Importance of Operating Cash Flow EBITDA and Customer Growth in the Cable Industry

40. During the late 1990s, cable companies went through a period of significant capital investment and consolidation. Companies installed wire cable networks at significant expense, while also acquiring smaller companies. During this period, it was not unusual for cable companies' expenses to exceed revenues. For stock market analysts who followed the industry, though, the short term losses were not important so long as the companies were

building solid customer bases while sustaining a significant positive cash flow growth rate.

41. Critical to the assessment of the strength of a cable company's customer base was the degree to which it grew internally (rather than through acquisitions). Such growth indicated that customers were pleased with services and were not defecting. This became particularly critical as the cable companies faced stiff competition from satellite television companies, which did not rely upon costly underground wire cable systems.

42. "Operating cash flow" was also an important measure of cable companies' performance. Technically known as "EBITDA," operating cash flow was a commonly used alternative means of gauging the quality of a company's performance. Until recently, EBITDA was also perceived to be a more reliable measurement of the company's results, since it reflected the company's core operating costs during any period (rather than capital investments whose benefits would be realized over a longer time frame). Cable industry companies and analysts tended to use the terms EBITDA and "operating cash flow" interchangeably.

Generally Accepted Accounting Principles Applicable to Cable Companies

43. Given the significance assigned operating cash flow, it was critically important whether a company expensed certain costs, or capitalized them over a period of time (in which case they were excluded from operating cash flow). Generally Accepted Accounting Principles ("GAAP") govern the accounting for such costs and the determination of whether they are expensed or capitalized.

44. Financial Accounting Standard ("FAS") 51 governs the standards for accounting on specific issues related to the cable industry. Among other things, FAS 51 states:

> a. Labor costs associated with installing new services on the *first visit* to an address can be capitalized, and then depreciated over a period no longer than the period used to depreciate the cable television plant.
>
> b. A portion of associated "indirect" costs, that are associated with installation or upgrade labor costs may likewise be capitalized.
>
> c. The costs of subsequently disconnecting or reconnecting a subscriber (or an address) must be expensed. Thus, the second time a service is enabled at an address (even if it is a new subscriber), it must be expensed in the period incurred.
>
> d. "Subscriber related costs" and general administration expenses must be expensed in the period incurred. These costs include:
>
> > Cost of billing and collection, bad debts, mailings, repairs and maintenance of taps and connections, general and administrative systems costs such as salary of the system manager and office rent, programming costs for additional channels used in the marketing effort or costs related to revenues from per channel or per program service, and direct selling costs.

Charter's Accounting Policies

45. Throughout the Class Period, Charter's *stated* accounting policy for expenses conformed to GAAP. That *stated* policy was:

> Costs capitalized as part of new *customer installations* include materials, subcontractors costs, internal direct labor costs, including service technicians and customer care representatives and internal overhead costs incurred to connect the customer to the plant from the time of installation scheduling through the time service is activated and functioning. We capitalize incremental and direct contract acquisition costs to the extent realizable from future revenues. The overhead rates established are based on a combination of internal company-wide overhead analysis and internal time and motion studies of specific activities. These studies are updated to adjust for changes in facts and circumstances. . . . The *costs of disconnecting and reconnecting* a customer are charged to expense in the period incurred. *Expenditures for repairs and maintenance* are charged to operating expense as incurred, while equipment replacements and betterments, including the replacement of drops, are capitalized. [Emphasis Supplied].

46. While the Company's stated policy conformed to GAAP, in actual practice, as discussed below, the Company consistently violated its own policy and GAAP by arbitrarily capitalizing material portions of certain labor related expenses in order to artificially enhance its operating cash flow results in line with Wall Street's expectations. This dovetailed with Charter's fraudulent inflation of its internal customer growth rate, also detailed below.

47. The favorable, though fraudulent, results that Charter disseminated during the Class Period were intended to enable the Company to meet analysts' forecasts and thereby prop up the price of Charter stock. In turn, this enabled the Company to continue to use its stock as valuable currency on its acquisition spree. In 1999 and 2000 alone, Charter completed sixteen acquisitions. Such transactions include: (i) the acquisition of Bresnan Communications Company (involving cable systems in Michigan, Minnesota, Wisconsin and Nebraska) for approximately $3.1 billion, in which $1.0 billion in Company equity was utilized to finance such purchase price; (ii) a stock for stock merger with Cablevision of Michigan, Inc., a cable system in Kalamazoo, Michigan, in which Charter issued Class A common stock purportedly valued at approximately $170.6 million; and, (iii) the acquisition of several cable systems from Cable USA, Inc., and its affiliates for a total purchase price of $100.3 million, financing more than one-half of such purchase ($55.7 million) with the Company's Series A Convertible Redeemable Preferred Stock.

THE FRAUDULENT SCHEME

48. Throughout the Class Period, defendants Kalkwarf and Barford were principally responsible for making sure that the Company met Wall Street's expectations, regardless of whether doing so reflected Charter's true operating and financial condition. These defendants instructed lower level personnel, including the senior operating officers of each division, to utilize certain fraudulent techniques to insure that the "numbers" were indeed "met." In order to accomplish these ends, defendants Kalkwarf and Barford instructed other personnel to

inflate the customer counts and arbitrarily capitalize certain costs. In addition, as discussed below, defendants Kalkwarf and Barford engaged in kickback arrangements with Scientific-Atlanta and Motorola for the sole purpose of materially inflating Charter's revenue and operating cash flow.

Inflation of the Customer Counts and Internal Growth Rates

49. As discussed above, Charter touted its 2+% internal growth rate as being the best in the industry. To meet this rate, the Company had to annually add up to 140,000 new customers to its subscriber base by means other than purchasing other cable companies.

50. Analysts were enamored with the Company because of this growth rate. As a Credit Suisse analyst commented in a report issued on May 14, 2002: "Charter has historically been one of the fastest-growing cable MSO's owing to industry-leading basic sub[scriber] growth. . . ." It also meant that Charter was successfully confronting the increased competition from satellite television companies.

51. This appearance of internal growth was a fraudulent illusion created by defendants to cover up the absence of any genuine internal customer growth. But for this scheme, Charter would have reported that the internal customer growth rate was flat, rather than 2+%. Plaintiffs' investigation indicates that this scheme was long-standing and grew exponentially throughout the Class Period. The Grand Jury charged that the *criminal* scheme to inflate subscribers commenced "in or about May 2001" when "it became clear to defendants that Charter

would not reach its second quarter subscriber growth projections if its normal business practices for disconnecting customers were followed."

52. Pursuant to this scheme, defendants Kalkwarf and Barford instructed employees during weekly conference calls and in other communications to "manage" disconnects of customers in order to reach subscriber growth rate estimates projected by Wall Street analysts.

53. Among other things, Charter personnel inflated the customer count by the following fraudulent techniques:

a. Whenever a customer requested termination, or was otherwise 60 days or more behind in payments, the customer should have been disconnected and/or no longer counted in the subscriber base. In order to avoid the adverse impact this would have had on reported figures, Charter personnel routinely were told to "hold disconnects," that is, to not process the paperwork for the termination. Company-wide, this amounted to over 100,000 customers during the Class Period. These terminations, if treated properly, would have wiped out all of the Company's reported internal customer growth rate.

b. At the beginning of the Class Period, the practice was to hold disconnects until after the close of the quarter, to enable Charter to make its numbers, and then to process the terminations. Each quarter's internal growth figures was materially inflated by the failure to exclude these customers who the Company knew were no longer paying for the service. As the Class Period progressed, the period for holding disconnects was extended beyond the end of one quarter, and cumulatively expanded.

c. Charter personnel were also instructed to hold the disconnects of customers who had been given 3-6 months of free trial service, but had refused to pay after the end of the trial period. Nonetheless, during the free trial period, Charter assigned a nominal fee to these accounts in order to include them as paying subscribers, even though the Company did not generate a bill for these accounts and did not receive any revenue from them.

d. Charter personnel were instructed to routinely double-count customers if they (i) moved from one location to the next (counting both their prior and new location); (ii) upgraded their account (counting the old service and the additional service separately); and/or (iii) reactivated service (counting the prior service and the reactivated service separately).

e. Charter personnel were instructed to routinely misclassify its cable customers in order to paint a false picture of internal growth. Charter offered customers its basic cable package, or alternatively, just access to the Internet (data access, or digital-only customers). The former were much more desirable, since charges for the basic package were considerably higher than Internet access only. Charter thus routinely: (i) included 50% of the monthly fee paid by digital-service-only customers in the basic cable revenues; and, (ii) included such digital-only customers in the total count of the basic cable customers. This enhanced the false appearance of the Company's customer growth rate.

f. As further evidence of the fraudulent nature of this overcounting scheme, Charter offices routinely maintained two sets of books regarding customer counts: (i) the first set included the inflated numbers, which

incorporated "holds" on disconnects and other devices which overstated Charter's true subscriber count (but reached the "quota" assigned to that office), and were passed on to corporate headquarters; and, (ii) the second set, which contained the actual, lower numbers, which were utilized to calculate employee bonuses.

g. By way of example, during the period 1999 through 2002, Charter's offices in Georgia actively engaged in hold disconnects practices. Sometimes customers were disconnected in the field, but the disconnect was not processed in the Company's billing system. Other times, customers were not even disconnected in the field. Such disconnects were held until the local office turned in its subscriber count and financial reports to the regional offices at the end of each quarter, after which the disconnects were processed.

54. Even though customers slated for disconnection were not paying, or had requested termination, Charter continued to routinely bill them. To avoid complaints from customers who had requested termination, but whose disconnects were subject to "holds," Charter resorted to issuing bills to these customers but changing the mailing address to Charter's own offices. This enabled the Company to record the customers as active (and record their bills as payable). Such examples include:

a. Starting in July 2001, Charter's General Manager in Columbia, Tennessee, Don Grammar, following instructions that were received from headquarters, ordered his office to generate and mail out phony bills for terminated customers (as it had previously), but to change the addresses on such bills to Charter's *own* office instead of the customer. In some cases, the bills and envelopes

were also addressed "ATTN DON," reflecting the name of the General Manager.

b. When an employee in the Columbia, Tennessee office raised questions about the legality of the inflated subscriber counts, she was told by the General Manager's administrative assistant that *corporate headquarters* was ordering all of its offices to delay processing the disconnects. Copies of such bills are attached.

55. Some offices took the fraudulent invoices process one step further, and created fictitious accounts with invoices mailed to Charter offices. For example:

a. In its Duluth, Georgia offices, a senior officer instructed customer service representatives to create such phony billings, have them mailed out to a Charter address so that they would be returned to Charter, and locked in the filing cabinet in his office. Fictitious customer names, such as "Jack Daniels" and "Dale Earnhardt," were utilized in such a scheme.

b. False subscriber accounts were also created at Charter's Stockbridge, Georgia offices at the direction of Phil Skinner, the General Manager and Director of Operations for Charter's Southern Region.

56. Several Charter employees, including defendants McCall and Smith, raised objections to the practice of holding disconnects in order to meet projected subscriber numbers. Nonetheless, defendant Barford insisted that employees hold the disconnects in order to make the numbers. Despite their objections, Smith and McCall relayed these instructions to subordinates knowing that this would results in Charter publicly reporting materially inflated subscriber counts.

57. Charter made sure that its employees knew that this was the way the Company did business by quickly terminating any lower level personnel who questioned or complained about the policy:

a. When employees in the Maryville, Illinois office questioned these practices at a meeting in late 2001 or early 2002, they were threatened by the head of Human Resources with the loss of their jobs and the loss of any severance if they made any public disclosures of the above-described practices.

b. Some of these terminations involved generous severance packages that sought to preclude anyone from discussing the Company's illegal business practices with anyone. William Reilly (Charter's finance director for Georgia) was the beneficiary of such a package.

58. Other specific examples of instances where disconnects were delayed beyond the end of quarters so that Charter could "make its numbers" during 2001 include:

a. In weekly conference calls, Kalkwarf and Barford directed other Charter officers to inflate subscriber growth rates in order to meet internal and analysts' projections.

b. In response to these directives, defendant McCall, Vice President of Operations for the Eastern Region, specifically ordered Regional Directors in Georgia (Phillip Skinner, William Reilly and Michael Davolt) to hold disconnects until after the end of quarters. At the hearing on July 25, 2003 where he entered his plea of guilty to the indictment, defendant McCall admitted that he was "instructed to meet certain quarterly expectations"

about the number of subscribers, and further acknowledged that the scheme involved "a lot of people in the company."

c. In response to these directives, defendant Smith likewise ordered personnel to hold disconnects until the end of quarter during 2001. At a meeting that took place on September 14, 2001, that was attended by numerous Charter executives, defendants Barford and Kalkwarf presented information that Charter had, at the time, 60,000 to 90,000 "managed" disconnects, i.e., customers who had not paid their bills or had voluntarily terminated their accounts, and were due to be cut-off, but were not in order to enable Charter to make its subscriber count growth rate numbers.

d. On or about October 5, 2001, defendant Barford e-mailed employees at Charter's divisions instructing them to provide "basic net gain in 4Q to get to 1% and 1.4% growth rate for the year." Consistent with his plan to maintain a reserve of disconnects that could be used in the future to continue managing the subscriber count growth rate, Barford added, "[Then] tell me how many managed disconnects you would still have left over after getting to these numbers."

e. In response to these directives, in October 2001, defendant Shreffler, Vice President of Operations for the Mid-West Division, ordered all disconnects that were being processed in the field not to be processed in the data system. These instructions were conveyed throughout the Division to Charter's offices such as that in Maryville, Illinois (where Charter had been founded in 1993), with the instructions "complete it in the field, but hold the paperwork."

f. Consistent with Barford's October 4, 2001 directive, throughout the fourth quarter of 2001, the Maryville, Illinois system alone had approximately 2,400 customers who had either requested disconnects or had already been physically disconnected, but who were still being counted in the Company's subscriber base. This number can be verified by reviewing the "no truck" data reports in the CableData system during and immediately after the period. Indicative of the degree to which this practice inflated the reported subscriber growth rates, there were 50,000 total customers for the entire Maryville region. Thus, the amount of disconnects still counted as active customers totaled nearly 5%, which was over twice the reported internal customer growth rate for the entire Company.

g. Other Charter divisions likewise followed Barford's directive. In October, 2001, defendant Fenger, the Senior Vice President of Operations for Charter's Western Division, specifically ordered that the processing of all disconnects be halted for the remainder of the year. Fenger did so with the knowledge of, and indeed in response to, discussions with Kenneth Rhodes, a senior officer in Charter's management.

h. This directive was consistent with the policy Fenger had been enforcing for several years. When previously questioned by a district director of operations about this disconnect policy, Fenger bluntly replied "that's just how we do business."

i. On December 6, 2001, Barford e-mailed Kalkwarf and another senior Charter executive advising that "Basic [i.e. internal] growth for December should be over 60K holding discos."

j. In December 2001, an outside contractor for Charter (Cabletex) was specifically instructed to hold the 3,300 disconnects that were scheduled to be performed in the Dallas-Fort Worth market until after the close of the quarters. On another occasion, Charter personnel instructed Cabletex to hold any disconnects until after a shareholder's meeting.

k. The specific directive to hold disconnects in the Long Beach, California office in order to artificially boost subscriber counts came from the Senior Vice President for that Region and was consistent with what was happening throughout all of Charter's local and regional offices, as directed by corporate headquarters.

59. As 2001 drew to a close, Charter executives began discussing an exit strategy from this scheme, fully aware that the Company would have to purge from its rolls those customers who should have been written off long ago.

a. On December 7, 2001, Barford e-mailed Kalkwarf and stated: "We are trying to figure out how many we could disconnect in December and still be in line with others. Is .5% or .6% sellable without revising downward [guidance]."

b. In a December 2001 memo to defendant Barford, defendant Kalkwarf suggested that Charter might "bleed the disconnects in over time" or "take the hit in the first quarter on the call for the change in strategy." Kalkwarf concluded by stating: "We should still take a hit (140,000 customers times $3600 per customer is just under $1 per share) but at least we are running the business and we can argue that we did end the year at approximately 1%."

c. Shortly after, on December 10, 2001 Kalkwarf e-mailed Barford and a senior Charter executive urging that they "stick with original plan to get 61,000 net gain for December" which would "help us get revenue and cash flow for the year. . . ." In another e-mail of the same day, Kalkwarf further urged that:

> My thoughts are to discuss the issue in the first quarter of next year as we are going to take a hit for it no matter what and if we have 0 or negative growth this year after our statements of last week and earlier we will take two hits – one for customer growth and one for continued lack of [credibility].

d. The exit strategy was sealed in a December 21, 2001 e-mail by defendant Barford to defendant Kalkwarf and a senior Charter executive stating, "I want to give the field direction to dump all the voluntary and 120 day or greater nonpays right after cut [for the year end 2001]. . . ."

e. Charter personnel also sought to cover-up evidence of illegal practices immediately following the decision in early 2002 to write off over 125,000 accounts for which disconnects were on "hold." In Charter's offices in Duluth, Georgia, employees were instructed by Harold Collins, the Vice President and director of finance for the Georgia region, to shred financial documents and e-mails going back to 1998. Employees were told by another senior person in the office, Mark Marshall, that if they were asked about the practice of creating false bills "don't say anything."

Charter's Blatantly Improper Capitalization of Labor Costs, Overhead and Administrative Expenses

60. In addition to chronically inflating subscriber counts and revenues, defendants also distorted Charter's performance and profitability by improperly capitalizing certain costs (particularly labor costs) that should have been expensed, thereby materially inflating the Company's critical operating cash flow results. The purpose of this scheme was to create the illusion that, just as the Company's subscriber base was growing, so too were its earnings from such subscribers, as measured by operating cash flow/EBITDA.

61. But for this scheme, Charter's reported rate of operating cash flow growth would have been 6% for 2001 compared to 2000, rather than the 12.5% reported. The operating cash flow growth rate was also materially inflated for years 1999 and 2000.

62. The directives to capitalize portions of labor costs that GAAP required to be expensed originated with defendants Kalkwarf and Barford, who used Division and Regional officers to communicate the need to increase the rate of capitalization in order to avoid expected shortfalls in operating cash flow. As the Vice President of the Northeast Region wrote in a memorandum sent to all its offices during the Class Period, 35% of the salaries of customer service representatives had to be capitalized (rather than properly expensed) because the Company was "behind on the numbers."

63. Charter's widespread practice of capitalizing labor costs that should have been expensed not only violated GAAP as detailed in ¶¶ 43-44, *supra*, but was

inconsistent with its own policy as set forth in its public filings, particularly the portion related to repair and disconnection related expenses:

> The costs of disconnecting a customer are charged to expense in the period incurred. Expenditures for repairs and maintenance are charged to operating expense as incurred, while equipment replacement and betterments are capitalized (*See* ¶ 45, *supra*.)

64. Charter's improper labor capitalization practices were applied to several areas:

a. Virtually all labor-related costs were capitalized to some degree depending on the amount needed to make up the expected operating cash flow shortfall, even though GAAP only permitted capitalization of new customer installation costs.

b. Charter arbitrarily capitalized a significant portion of certain technician labor costs associated with (i) customer upgrades to digital service; (ii) repairs on installation; and, (iii) changes to splitters (devices in the home that divides a signal into multiple paths), when all such costs should have been expensed.

c. Charter routinely capitalized significant portions of the salaries related to customer service representatives, and large portions of management salaries as well. Both of those types of costs should have been expensed.

d. Charter routinely capitalized significant portions of "reconnect" costs (reconnecting subscribers who had requested that their cable be disconnected or whose service had been terminated for failure to pay their bills).

The percentage of capitalization changed from month to month, depending on the amount of savings needed to meet cash flow expectations. In the Duluth, Georgia office, 75% of these costs were capitalized during the Class Period.

e. These improperly capitalized costs totaled $93 million in 2001 and $52 million in 2000.

f. In order to further improperly capitalize costs, the Company also had outside contractors directly pay distributors for supplies and similar items, and then had the contractors include the costs of such goods in the bill for contractors' services. Charter then capitalized the entire cost as "outside contracting," when in fact the items paid for by the contractors were strictly for Charter's use and should have been expensed.

g. At the direction of regional officers, including John McFerron, the Regional Vice President of Finance for Charter's North Central region (based in Madison, Wisconsin), Charter offices also improperly capitalized 100% of the labor costs associated with its Internet Division. Offices compounded this inflation by shifting additional employees into the Internet division to maximize the capitalization of labor costs.

h. Charter also paid third-party contractors to conduct marketing campaigns. The Company improperly deferred the cost of these services rather than expensing them as incurred. As a result, $59 million in marketing campaign expenses were improperly deferred rather than expensed in 2001. Such accounting for marketing campaigns was in direct violation of Statement of Position 93-7 ("SOP 93-7"), *Reporting on Advertising Costs*, which governs

the accounting for advertising costs under GAAP. SOP 93-7 states the following:

> The costs of advertising should be expensed either as incurred or the first time advertising takes place except for:
>
> a. Direct-response advertising (1) whose primary purpose is to elicit sales to customers who could be shown to have responded specifically to the advertising and (2) that results in probable future economic benefits (future benefits). Examples of the first time advertising taking place include the first public showing of a television commercial for its intended purpose and the first appearance of a magazine advertisement for its intended purpose.
>
> b. Expenditures for advertising costs that are made subsequent to recognizing revenues related to those costs.

65. Charter not only improperly capitalized the direct labor costs described above, but also improperly capitalized allegedly associated general and administrative overhead expenses. By way of example, John McFerron ordered that 47% of all general and administrative expenses be capitalized.

66. These percentages of labor and other costs that were capitalized were unrelated to the amount of time or portion of expenditures that were appropriately spent on customer implementation related services, but instead related strictly to the amount of the operating cash flow shortfall that Charter personnel were instructed to cover.

67. As a result of this scheme, the amount of purportedly related overhead and administration costs that Charter capitalized per subscriber was nearly twice that of Charter's competitors.

68. While much of the implementation of the improper capitalization was done at the local level, a significant portion was also performed at a centralized location, in Charter's Denver, Colorado offices, where all the Company's regional and divisional reports were consolidated. Accounting personnel in this office were instructed to "skew the numbers" by moving costs from one account code (which was to be expensed) to another code (which was to be capitalized) in order to make up any cash flow shortfalls.

69. In addition, accountants in Charter's Denver offices also artificially kept down the Company's expenses by directing the regional offices to hold payments due for contract labor at the end of each quarter until the following quarter, or even later. By the end of 2001, for example, Crown Fiber, one of the Company's largest outside contractors, was owed approximately $5 million by Charter. Charter avoided recognizing this expense by deferring the payment and not recording any account payable.

70. Finally, Charter also improperly capitalized certain promotional costs for new programs which should have been expensed in the year incurred.

71. As a result of this improper capitalization of expenses, Charter's reported operating cash flow was materially overstated by at least $146 million in 2001, and by $87 million in 2000.

Manipulation of Revenues

72. In order to maintain the illusion of internal customer growth, Charter also had to show revenue growth consistent with such inflated customer counts. This was accomplished by manipulating the Company's centralized billing system. Under its own revenue recognition policies, Charter's monthly numbers were supposed to represent sales made from the 21st day of the month to the 21st day of the following month. Bills had to be mailed by the 21st of the month to have their charges booked as revenue for the month.

73. Billing results for those offices using the CSG billing system (which were only a small percentage) reflected the amount of bills actually sent by the 21st of each month (because the system had a hard-coded month-end cut-off date set for the 21st of each month). However, the vast majority of the Company's offices, those using the Cable Data billing system, had their closing extended to the 1st or 2nd day of the following month unless it was the end of the quarter, in which case Charter headquarters extended the billing cut-off date for regional offices by four or five days.

74. Charter also inflated its revenues by including all new program "launch fees" paid by suppliers at the outset of program contract period, rather than amortizing such fees over the entire term of the contract.

Charter Entered Sham Arrangements with Defendants Scientific-Atlanta and Motorola Intended To Artificially Boost Charter's Revenues and Operating Cash Flow

75. By way of background, in order to provide digital cable television service, it was necessary for Charter to

purchase digital cable converter boxes for installation in customers' homes. Purchases of these digital cable converter boxes became a large capital expense for Charter, and made Charter important customers of defendants Scientific-Atlanta and Motorola, the nation's two largest manufacturers of such converter boxes and other equipment used by cable companies.

76. In August, 2000, defendants Kalkwarf and Barford realized that the Company was facing a year-end short fall in operating cash flow relative to amounts projected by Charter and those analysts who covered the Company. In order to help cover that shortfall, the Company entered into sham agreements for "advertising" from defendants Scientific-Atlanta and Motorola to inflate Charter's operating cash flow for the fourth quarter of 2000.

77. As part of these sham transactions, Charter agreed to pay Scientific-Atlanta and Motorola an additional $20 for each digital converter so long as the suppliers repaid that same amount to Charter in the form of "advertising." Thus, the price increases paid by Charter and "advertising" payments made by the vendors constituted "wash" transactions with no economic substance.

78. Although these sham agreements could have no legitimate effect on Charter's operating cash flow, defendants exploited such transactions by fraudulently accounting for them in such a way as to significantly and artificially inflate Charter's operating cash flow during the Class Period, to wit, by treating the "payments" from Scientific-Atlanta and Motorola as "revenues" when in fact they were simply the return of Charter's own monies.

79. On the other hand, Charter avoided any adverse effect or decrease on its operating cash flow by capitalizing the payments made to Scientific-Atlanta and Motorola, under the pretext that they were related to the purchase of equipment. Thus, although the advertising payments had no economic effect whatsoever on Charter, through their misleading and fraudulent accounting for the transactions, the defendants used them to artificially increase Charter's publicly disclosed operating cash flow by at least $17 million dollars during the fourth quarter of 2000. But for this scheme, Charter's reported revenues and operating cash flow would have fallen short of analyst expectations.

80. Indicative of the deliberately fraudulent nature of these transactions, defendant Kalkwarf discussed the concept with defendant Arthur Andersen, the Company's outside auditors, in August 2000, prior to any payments being exchanged. At the time, Arthur Andersen stated that Charter could not recognize the advertising payments as revenue because they appeared integrally related to the cost increases being paid by Charter. Arthur Andersen counseled that Charter could recognize the advertising fees as revenues if the additional payments for the converter boxes and the advertising were: (i) at fair market value, (ii) unrelated to one another, and (iii) negotiated at least a month apart. In late August 2000, defendant Kalkwarf advised Arthur Andersen that Charter would fulfill those conditions. In September 2000, Kalkwarf falsely told Arthur Andersen that the advertising and supply contracts with Scientific Atlanta and Motorola had been negotiated by two separate departments at Charter a month apart from one another. To lend further credibility to these claims, even though the set-top box price increases were not finalized with either vendor until late

September 2000, the contracts were back dated to August 2000 on the instructions of defendants Barford and Kalkwarf. This gave the false appearance that the set-up box price agreements were negotiated a month before the advertising contracts which were dated in late September.

81. Despite being aware that Charter was seeking to generate additional revenue through a series of questionable transactions with these two vendors, Arthur Andersen accepted the explanations provided by Kalkwarf and Barford, and failed to perform further audit checks (e.g., requesting additional verification from the vendors) as it was required to do under Generally Accepted Auditing Standards.

82. As noted earlier, on February 10, 2003, Scientific-Atlanta disclosed that it had been subpoenaed by the Grand Jury. Scientific-Atlantic had been previously charged with entering into similar sham transactions with another notorious cable company, Adelphia Communications, Inc. The Indictment returned by the Grand Jury investigating Charter detailed this scheme, though it did not identify Scientific Atlanta or Motorola by name.

Defendants' Direct Participation in and Knowledge of the Fraud

83. Defendants Kalkwarf and Barford were directly involved in orchestrating directives in the Company to ensure that Wall Street estimates were met, and negotiating the sham transactions with Scientific-Atlanta and Motorola. They were fired because of their involvement in the fraudulent scheme. They have since been indicted by the Grand Jury.

84. Defendant McCall, Senior Vice President for the Eastern Division, was also actively involved in implementing the "hold disconnects" practice. An e-mail from Josh Jamison, one of the Regional Vice Presidents, to employees in the Massachusetts region, requiring that the Company hold all disconnects under 90 days past due, resulted from a meeting between defendant McCall and Jamison. In his Plea Agreement dated July 25, 2003, defendant McCall admitted he was directed to hold or postpone disconnects in order to "meet the forecasted numbers" for the subscriber growth rates that Charter had publicly projected for the second, third and fourth quarters of 2001. McCall further admitted in his Plea Agreement that in response to these directives, he:

> a. [G]ave instructions to hold disconnects to each of the regional vice presidents working below him. Soon after the end of the second, third and fourth quarters of 2001, these held disconnects would then be disconnected or "cleaned-up."
>
> b. [K]new that the purpose of holding these disconnects before the end of the quarter and then cleaning up disconnects afterward was to inflate Charter's quarterly growth in subscriber numbers that were intended to be reported to the public. During these quarters, without the holding of disconnects, Charter would not have been able to meet its quarterly subscriber forecasts.

85. Defendant Smith has been indicted by the Grand Jury for instructing subordinates to hold disconnects during the second, third and fourth quarters of 2001 "knowing that these instruction would result in Charter

reporting inflated subscriber numbers to the investing public."

86. In response to the directives received from Charter's corporate senior officers, the senior officers of Charter's two (and subsequently three) Divisions informed regional personnel of the steps to be taken to ensure those numbers were met. By way of example, defendant Shreffler, the Senior Vice President of Operations for the Mid-West Division told his assembled staff at an "all employee" breakfast held on May 23, 2001, that he was brought in to bring the numbers up: "whatever it takes to get the numbers up . . . It will happen no matter what, no matter what it takes."

87. Defendant Shreffler directed all of his system managers to ensure that there would be "no disconnects" at the end of the quarters and when shareholder meetings were scheduled. This was intended to create the appearance that the Company's subscriber base was healthy and growing. Shreffler's employees were instructed to keep track of the disconnects by maintaining a handwritten list, so as to avoid any record of actual or pending disconnects in the computerized billing system. In October, 2001, defendant Shreffler ordered that all disconnects were not to be processed in the system.

88. Defendant Shreffler had worked his way up the ranks at Charter (initially in Denver and Minnesota regional offices) utilizing these same techniques, and was rewarded by senior corporate officials until he rose to head one of the Company's three divisions. Defendant Shreffler, known as "Coach" by his subordinates, accepted nothing less than the goals or quotas that were set by corporate

headquarters, refusing to accept numbers that fell short and telling employees to "make it work."

89. Consequently, when a customer service manager in the Central Division was asked by another employee why he was changing subscriber numbers, he replied that he wasn't going to give "Coach" numbers that he didn't like, and was "making the stockholders happy." This was consistent with Shreffler's own practices. When he became Senior Vice President of the Central Division in the middle of 1999, the accurate count of subscribers was reported to him on a daily basis. If he did not like the numbers, he ordered them changed. This was done by entries into the centralized data system, CableData or CSG.

90. In October, 2001, defendant Fenger ordered all disconnects to be held until after the close of the year.

91. Defendants Allen, Kent and Barford were otherwise alerted to Charter's practice of holding disconnects by a certified mail letter dated April 19, 2001, from a Marketing Manager at Charter's Long Beach, California office, in which he asserted that he had been fired on the pretext of groundless sexual harassment charges made against him, when in fact the real reason for his termination was because he was "questioning the over 2000 disconnects that were pending at the time." No response was ever received, although the "whistleblowing" employee did receive confirmation of receipt of such letter. On information and belief, defendant Kent was also at the September 14, 2001 meeting that, as described in the Grand Jury's Indictment, was "attended by numerous Charter executives' at which defendants "Barford and Kalkwarf presented information that Charter had between 60,000 and 90,000 managed disconnects."

92. Defendant Allen, as Chairman and controlling shareholder of Charter was responsible for creating the culture at the Company that accepted nothing less than meeting the numbers to "keep shareholders happy." Allen knew that the appearance of customer and operating cash flow growth was essential in securing additional financing that was critical to his plan to build a cable empire. He demanded that Charter officers meet these goals and recklessly turned a blind eye to this misconduct. Indeed, when Kent signaled in September 2001 that the customer growth rate might decline, Allen promptly fired him.

93. Defendant Vogel, Charter's President after defendant Kent's departure in September 2001, was aware of the true reasons for the write-off of over 120,000 customers that Charter announced on February 11, 2002, but deliberately mischaracterized those reasons in order to divert attention from the Company's prior fraudulent misconduct. *See* ¶ 136 (a)-(c), *infra*.

94. The Individual Defendants were otherwise aware of, or recklessly disregarded, the fraudulent scheme by virtue of their positions as senior operating and financial personnel in the Company.

DEFENDANTS' MISLEADING PUBLIC STATEMENTS AND MATERIAL OMISSIONS DURING THE CLASS PERIOD

The Misleading Nature Of The Statements

95. As detailed below, throughout the Class Period, Charter portrayed itself as a company with "organic" or "internal" growth of subscribers; apart from its numerous acquisitions of other cable companies. The Company also touted its operating cash flow growth rate and revenue

growth. As detailed in the foregoing ¶¶ 48-82, *supra*, such statements were materially false and misleading, for the reasons summarized below:

a. Charter's internal growth rate for subscribers was artificially and materially inflated as a result of the fraudulent scheme described above.

b. But for the fraudulent subscriber scheme, the Company would not have been able to boast that it was the industry leader "in generating internal growth." Indeed, as a result of the scheme, the Company would have experienced no growth of its basic video cable subscribers during two years of the Class Period.

c. Charter also materially inflated its operating cash flow/EBITDA by: (i) improperly recognizing program launch fees at the outset of the contract rather than over the entire term of the contract; (ii) failing to write off customers and related account receivables on a timely basis; and, (iii) improperly capitalizing labor and other costs related to the servicing and termination of accounts and other general and administrative overhead expenses, that GAAP and the Company's own accounting policies required to be expensed.

d. But for such improper accounting, Charter would not have been able to boast that its operating cash flow rate was "twice that of any other cable operator." In fact, Charter's 2001 EBITDA growth rate would have been half the amount reported.

e. As a result of the foregoing schemes, Charter's reported financial results, including revenues, expenses, and operating cash flow/EBITDA, were materially

misstated throughout the Class Period, causing the price of Charter stock to be artificially inflated.

The Statements

96. Charter's Initial Public Offering commenced on November 8, 1999, and the sale to the public of the 170,00,000 shares of common stock at $19.00 per share raised approximately $3.23 billion. The November 4, 1999 Registration Statement and Prospectus represented in connection with the offering stated, among other things, that for the six months ended June 30, 1999, Charter had $594 million in revenues, with over $237 million in EBITDA. The IPO offering materials also represented that the Company was currently serving 3.7 million customers, and that an additional 2.5 million would be added through acquisitions. In its Registration Statement and Prospectus, Charter represented that its "internal customer growth" in 1998, without giving effect to the cable systems it acquired that year, "was 4.8%, more than twice the national industry average of 1.7%." The Registration Statement was signed by defendants Allen, Kent and Kalkwarf.

97. The statements regarding Charter's cash flow, customer growth rate and revenues were materially misstated for reasons set forth in ¶ 95 (a)-(e), *supra*.

98. On February 16, 2000, Charter announced its fourth quarter 1999 financial results:

> **Charter Communications, Inc. Announces Fourth Quarter Financial Results for 1999**
>
> ST. LOUIS – (BUSINESS WIRE) – Feb. 16, 2000 – Charter Communications, Inc. (Nasdaq:CHTR)

announced today financial results for the three months and the year ended December 31, 1999.

"Charter Communications ended 1999 with strong fourth quarter operating results and the company is in an excellent position to carry that momentum into 2000," said Jerald L. Kent, President and CEO of Charter. "We continued to generate *double-digit cash flow growth and once again will be among the industry leaders in internal customer growth.*" Charter reported that pro forma fourth quarter revenues and adjusted EBITDA were $763.1 million and $370.3 million, respectively, which were in line with expectations. Further, fourth quarter revenues and adjusted EBITDA grew 9.9% and 12.3%, respectively, and internal customer growth was 3.1% over the year-ago period for those cable systems owned or managed by Charter during the comparable periods.

. . . .

Revenues increased by $26.2 million or 9.9% when comparing the revenues for the three months ended December 31, 1999 to the results for the comparable systems for the three months ended December 31, 1998. This increase is due to a net gain of approximately 68,500 or 3.1% basic customers between quarters and retail rate increases implemented in certain of the Company's systems.

. . . .

The Company experienced growth in adjusted EBITDA of approximately $15.5 million or 12.3% when comparing adjusted EBITDA for the quarter ended December 31, 1999 to the results for

> the same systems for the quarter ended December 31, 1999. Adjusted EBITDA margin increased from 47.7% to 48.7% when comparing the similar periods.
>
> [Emphasis Supplied]

99. The February 16, 2000, press release was misleading for the reasons set forth in ¶ 95 (a)-(e), *supra*.

100. On March 28, 2000, Charter filed its Form 10-K for the year-end 1999 with the SEC. The Form 10-K repeated the same financial information that was announced in the press release of February 16, 2000, referenced *supra*, and was signed by defendants Allen, Kent and Kalkwarf. In its "Report of Independent Public Accountants," defendant Arthur Andersen gave the following unqualified opinion on Charter's financial statements contained in its 1999 Form 10-K:

> In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Charter Communications, Inc. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for the year ended December 31, 1999 and for the period from December 24, 1998, through December 31, 1998, in conformity with accounting principles generally accepted in the United States.

101. This statement is false and misleading for reasons set forth in ¶ 95(a)-(e), *supra*.

102. On May 3, 2000, Charter announced first quarter 2000 results in a publicly disseminated press release:

Charter Communications, Inc. Announces First Quarter 2000 Financial Results

ST. LOUIS – (BUSINESS WIRE) – May 3, 2000 – Charter Communications, Inc. (Nasdaq:CHTR) today announced financial results for the three months ended March 31, 2000. Pro forma for the acquisition of Bresnan Communications in February 2000, revenues were $759.3 million and operating cash flow after deducting corporate overhead was $352.0 million for the first quarter of 2000 . . .

. . . .

Revenues increased by $27.2 million or 10.2% when comparing the revenues for the three months ended March 31, 2000 to the results for the comparable systems for the three months ended March 31, 1999. This increase is due to a net gain of approximately 51,900 or 2.4% basic customers between quarters and retail rate increases implemented in certain of the Company's systems.

. . . .

The Company experienced growth in operating cash flow of approximately $17.4 million or 13.7% when comparing operating cash flow for the quarter ended March 31, 2000 to the results for the same systems for the quarter ended March 31, 1999. Operating cash flow margin increased from 47.2% to 48.7% when comparing the similar periods.

103. The foregoing 1Q00 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

104. On May 12, 2000, Charter filed its Form 10-Q for the first quarter of 2000 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of May 3, 2000, referenced *supra*, and stated (as did each subsequent Form 10-Q issued during the Class Period) that the accompanying consolidated financial statements "have been prepared in accordance with generally accepted accounting principles . . . for interim financial information and the rules and regulations of the Securities and Exchange Commission," and "include all adjustments, which consist of only nominal recurring adjustments, necessary for a fair presentation of the results for the periods presented." The Form 10-Q was signed by defendant Kalkwarf. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

105. On August 2, 2000, Defendants continued to mislead investors, when announcing Charter's second quarter 2000 results in a press release:

> **Charter Communications, Inc. Announces Second Quarter 2000 Financial Results; Increases in Revenue, Operating Cash Flow, and Customers Continue**
>
> ST. LOUIS – (BUSINESS WIRE) – Aug. 2, 2000 – Charter Communications, Inc. (Nasdaq:CHTR) today reported increases in revenue, operating cash flow, and customers for the three months ended June 30, 2000.
>
> Revenue grew 9.8% to $794.8 million and operating cash flow increased 16.4% to $373.2 million for the second quarter of 2000 compared to the pro forma results for the second quarter of 1999. For those cable systems owned or managed by

> Charter during the second quarter of both 2000 and 1999, revenue and operating cash flow grew 12.8% and 15.6%, respectively, and customer growth was 2.3% over the year-ago period.

106. The foregoing 2Q00 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

107. On August 14, 2000, Charter filed its Form 10-Q for the second quarter of 2000 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of August 2, 2000, referenced *supra*. The Form 10-Q was signed by defendant Kalkwarf. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

108. On November 2, 2000, Charter disseminated a press release announcing the Company's third quarter 2000 financial results. Again, the Company touted the growth in Charter's basic cable customer numbers:

> **Charter Communications Reports Continued Revenue, OCF, and Customer Growth in Third Quarter 2000 Financial Results**
>
> Aggressive Digital Video Deployment Contributes to 20% OCF Growth
>
> ST. LOUIS – (BUSINESS WIRE) – Nov. 2, 2000 – Charter Communications, Inc. (Nasdaq:CHTR) today reported continued growth in revenues, operating cash flow (OCF), and basic, digital and data customers for the three months ended September 30, 2000, compared to pro forma year-ago results.

Third Quarter Highlights

Pro forma revenues increased 13.9% to $842.9 million and pro forma operating cash flow increased 20.2% to $400.6 million for the third quarter of 2000 compared to the pro forma results for the third quarter of 1999. Charter added over 55,000 basic cable customers during the third quarter, contributing to a year-to-year increase of approximately 2.3% compared to the pro forma customer level of 6,178,800 at September 30, 1999. . . .

For "same-store" cable systems owned by Charter during the third quarter of both 2000 and 1999, revenues and system operating cash flow grew 12.8% and 19.5%, respectively. These systems represented 2,671,000 customers at September 30, 2000, reflecting a 2.3% growth rate in basic customers compared to a year ago.

109. The foregoing 3Q00 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

110. On November 13, 2000, Charter filed its Form 10-Q for the third quarter of 2000 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of November 2, 2000, referenced *supra*. The Form 10-Q was signed by defendant Kalkwarf. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

111. On February 15, 2001, Charter continued to mislead investors when announcing its 2000 year-end results in the following press release:

Charter Communications Reports Continued Revenue, OCF, and Customer Growth in Fourth Quarter 2000 Financial Results

Aggressive Digital and High-Speed Data Deployment to Drive 2001 Growth

ST. LOUIS – (BUSINESS WIRE) – Feb. 15, 2001 – Charter Communications, Inc. (Nasdaq:CHTR) today reported continued acceleration in the growth of revenues, operating cash flow (OCF), and basic, digital and data customers for the three months ended December 31, 2000, compared to pro forma year-ago results and compared to all other quarters in 2000.

2000 Financial Highlights

Jerry Kent, President and CEO, said "I'm pleased to report that we met, or in most cases significantly exceeded, all of the goals we set at the start of the year, *as well as those expected by Wall Street analysts*. In the fourth quarter, we capped the year with OCF growth that is almost twice that of any other major cable operator. We saw *acceleration in core basic customer growth*, which indicates the success of our digital strategy. And we ended the year with advanced service deployments that exceeded our original optimistic expectations. . . ."

For the fourth quarter of 2000, revenues increased 15.8% to $893.9 million, and OCF increased 28.9% to $433.2 million compared to the pro forma results for the fourth quarter of 1999. Pro forma revenues and OCF for the year 2000 increased 11.9% to $3.30 billion and 19.0% to $1.56 billion, respectively, compared to pro forma 1999 annual results. Pro forma internal customer growth was 2.5% for the year 2000. "*We*

apparently retained our industry leadership in generating internal customer growth," Mr. Kent said. "Our aggressive approach to competition has enabled us to accelerate our internal customer growth throughout the year," he continued. At December 31, 2000, Charter served 6,350,900 basic cable customers, compared to 6,193,700 pro forma as of December 31, 1999, a pro forma net gain of 157,200 customers.

For "same-store" cable systems owned by Charter during the fourth quarter of both the years 2000 and 1999, revenues and system operating cash flow grew 18.3% and 28.9%, respectively. These systems represented 3,783,600 customers at December 31, 2000, reflecting a 2.2% internal growth rate in basic customers compared to a year ago.

[Emphasis Supplied].

112. The foregoing 4Q00 and year end 2000 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*. In addition, the foregoing results were materially inflated as a result of Charter's sham transactions with Scientific-Atlanta and Motorola by which Charter agreed to pay additional monies for goods, in return for these vendors paying Charter advertising fees.

113. On February 28, 2001, Charter filed its Form 10-K for the year-end 2000 with the SEC. The Form 10-K repeated the same financial information that was announced in the press release of February 15, 2001, referenced *supra*, and was signed by defendants Allen, Kent and Kalkwarf. Charter's Form 10-K for the year ended 2000 was materially false and misleading. In its "Report of Independent Public Accountants," defendant Arthur

Andersen gave the following unqualified opinion on Charter's financial statements contained in its 2000 Form 10-K:

> In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Charter Communications, Inc. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for the years then ended, and for, the period from December 24, 1998, through December 31, 1998, in conformity with accounting principles generally accepted in the United States.

114. On May 2, 2001, Charter announced its first quarter 2001 results in the following press release:

> **Charter Communications Announces Solid First Quarter Results; Digital Video and High-Speed Data Deployments Exceed Expectations**
>
> ST. LOUIS – (BUSINESS WIRE) – May 2, 2001 – Charter Communications, Inc. (Nasdaq:CHTR) today reported revenue and operating cash flow growth at the high end of previously stated guidance for the first quarter of 2001 . . .
>
> First Quarter Financial Highlights
>
> For the first quarter of 2001 revenues increased 14.4% to $873.8 million, and operating cash flow (OCF) increased 9.7% to $387.9 million compared to the pro forma results for the first quarter of 2000. Charter increased its customer base by over 2.0% compared to pro forma first quarter of 2000 to 6,349,800 customers. "We continue to deliver by increasing revenue and OCF through

internal and advanced broadband services customer growth made possible by our digital platform," Mr. Kent said.

115. In a conference call with analysts following the release of its quarterly results, senior Charter officers expressed confidence that its annual basic customer growth would exceed 2%, indicating an acceleration throughout the balance of the year. The Company attributed this increase in growth, in part, to "decreasing churn," i.e. decreasing loss of existing customers. (See UBS Warburg; ABN AMRO, 5/3/01).

116. The foregoing 1Q01 results and statements in the conference call were materially false, misleading and without reasonable basis for the reasons set forth in ¶ 95(a)-(e), *supra*.

117. On May 15, 2001, Charter filed its Form 10-Q for the first quarter of 2001 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of May 2, 2001, referenced *supra*. The Form 10-Q was signed by defendant Kalkwarf. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

118. Indicative of the degree to which analysts were beguiled by Charter's fraudulent image, Credit Suisse First Boston resumed coverage of the Company on June 4, 2001 with a "Strong Buy" recommendation based on Charter's perceived subscriber growth rate that was "twice industry average," attributable to "falling churn, better customer service and more sophisticated settling techniques." On June 5, 2001, Deutsche Bank issued a report projecting pro forma EBITDA growth at 14-16% for the year. Recommendations such as these, which were based

on defendants' fraudulent representations and guidance to analysts, propelled Charter's stock price to over $22 per share.

119. On July 30, 2001, Charter continued to mislead investors when the Company announced its second quarter 2001 results in the following press release, which states in part:

> **Charter Communications Exceeds Revenue, Operating Cash Flow Guidance; Strong Digital Video, High-Speed Data and Basic Customer Increases Continued During Second Quarter**
>
> ST. LOUIS – (BUSINESS WIRE) – July 30, 2001 – Charter Communications, Inc. (Nasdaq:CHTR) today reported second quarter 2001 revenue and operating cash flow growth exceeding Wall Street estimates. Increases in digital video, high-speed data, and basic video customers during the three-month period ended June 30, 2001 were in line with the company's previously stated guidance, according to Jerry Kent, President and CEO.
>
> Second Quarter Financial Highlights
>
> For the second quarter of 2001, revenue increased 16.1% to $928.5 million, and operating cash flow increased 14.1% to $428.1 million compared to pro forma results for the second quarter of 2000. This compares favorably to previous guidance of 13%-15% revenue growth and 11.5%-13.5% operating cash flow growth for the second quarter. Charter reported internal customer growth of 2.1% compared to pro forma second quarter of 2000 for a total of 6,388,300 customers
>
> . . . .

120. A conference call after the release of these results reinforced the upbeat, albeit false, impression provided analysts. As Richard Bilotti from Morgan Stanley Dean Witter commented in a report issued at the time, "The most important takeaway from the quarter and the call with management is the company's strong belief in the sustainability of these growth rates."

121. The foregoing 2Q01 results and statements to analyst were materially false, misleading and without reasonable basis for the reasons set forth in ¶ 95(a)-(e), *supra*.

122. On August 13, 2001, Charter filed its Form 10-Q for the second quarter of 2001 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of July 30, 2001. The Form 10-Q was signed by defendant Kalkwarf. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

123. On September 11, 2001, Charter announced preliminary third quarter 2001 results:

> **Charter Communications Expects Accelerated Growth in Third Quarter 2001 Advanced Services; Company Will Shift Focus From Basic Customer Growth to Advanced Services**
>
> PASADENA, Calif. – (BUSINESS WIRE) – Sept. 11, 2001 – Charter Communications, Inc. (Nasdaq: CHTR) said today that based on third quarter digital and high-speed data sales to date, it expects third quarter 2001 advanced services additions to exceed those of second quarter 2001. Charter President and CEO Jerry Kent said the

Company expects to meet or exceed the high end of guidance for year-end digital and high-speed data customers.

. . . . Mr. Kent said Charter has made a strategic decision to focus more of its marketing expenditures and management time on advanced service growth. "We've reviewed our internal marketing plans, management focus and current operating results in light of the current economic environment, and believe that a rebalancing of emphasis to digital and data sales at the expense of marginal increases in basic customer growth is the right business decision. Our number one priority now is to increase digital and data customers which provide higher profitability and competitive advantage."

Mr. Kent said he expects Charter's basic customer growth for 2001 to be less than the original guidance of at least 2 percent as a result of this refocus. "We'll remain mindful of the ongoing need for internal basic customer growth, and I'm confident Charter will continue to lead the industry as we have for the past five years."

"As advanced services are deployed to a rapidly growing number of customers, operating cash flow growth accelerates," Mr. Kent said. "Pro forma operating cash flow growth for the first half of 2001 was 11.1 percent. Despite the slowdown in economic conditions, this growth rate is expected to accelerate for the remainder of the year."

[Emphasis Supplied.]

124. The foregoing statements were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

125. While the foregoing representations were false and misleading, they were the first signal of a decline in Charter's customer growth rate. Indicative of the stock price inflation that had resulted from Charter's reports and projections of customer growth rates which had been bloated by the "hold disconnects" practice and other devices described above, this first disclosure triggered a 20% decline in the price of the Company's stock price, from a close of $20.04 on September 7, 2001, to a close of $16.00 on September 21, 2001, at 2-3 times the normal trading volume.

126. Further indicative of the emphasis that defendant Allen had placed on customer growth rate, following this reported decline in rate, defendant Kent was ousted as the Company's President and CEO. This was announced on September 24, 2001. News reports attributed Kent's departure to undisclosed disagreements and personality conflicts with defendant Allen.

127. This news further unsettled investors, who further bailed out of the Company, resulting in a decline in the price of Charter's stock to $12.00 per share on September 27, 2001. Consistent with the concerns raised by these events, Goldman Sachs reduced its EBITDA estimates for 2001, citing the "slower sub growth rate." (10/9/01)

128. On October 9, 2001, Charter named defendant Vogel as the Company's new President and CEO.

129. On November 1, 2001, defendants announced Charter's final third quarter 2001 results in a press release, which stated in part:

> **Charter Communications Reports Strong Third Quarter Advanced Services Growth**
>
> Company Continues to Pace the Industry with Internal Customer Growth
>
> ST. LOUIS B Charter Communications, Inc. (Nasdaq: CHTR) today reported double digit revenue and operating cash flow growth for the third quarter of 2001 resulting from continued consumer demand for broadband services. These results were highlighted by the addition of a record number of new cable modem customers during the third quarter.
>
> . . . .
>
> Third Quarter Financial Highlights
>
> For the third quarter of 2001, revenue increased more than 13% to $1.04 billion, and operating cash flow increased more than 10% to $467.5 million compared to pro forma results for the third quarter of 2000. Charter continued to pace the industry with internal customer growth of 1.1% compared to pro forma third quarter of 2000 for a total of 6,970,100 customers. "Basic customer growth has slowed after a planned reduction in discounting and basic service marketing efforts, part of a previously announced strategic shift of focus to advanced services that will better enhance operating cash flow growth. This focus is starting to pay off, as evidenced by our impressive advanced services growth. I'm especially proud of the men and women of Charter for their

perseverance in these challenging times," Mr. Vogel said.

130. The foregoing 3Q01 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

131. On November 14, 2001, Charter filed its Form 10-Q for the third quarter of 2001 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of November 1, 2001, referenced *supra*. The Form 10-Q was signed by defendant Kalkwarf. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

132. Investors became increasingly skeptical about Charter following the departure of defendant Kent, and particularly as concerns surfaced about the nature of its previously reported significant customer growth rates. In late 2001, the market began learning that Charter had engaged in a "practice of aggressively driving basic subscriber growth over the last two years" which had purportedly enabled the Company to increase its subscriber "base roughly twice as fast as its peers in 1999, 2000, and through much of 2001" (See October 4, 2002 Bank of America Securities report). As the Company began acknowledging that its growth rates were slowing, even some analysts became more cautious about the Company (still unaware that the prior growth rate was not simply the result of aggressiveness, but of covert manipulation of the figures).

133. Thus, on January 10, 2002, Morgan Stanley analyst Richard Bilotti reduced his rating from "Strong Buy" to "Outperform," citing slowing EBITDA growth, which, now at 10%, was "about 100-200 basis points below

the industry average." This came on the heels of the Company's acknowledgment on November 1, 2001, that its subscriber growth rate, which had been at 2.3% a year prior, had declined to 1.1% in the most recent quarter. These concerns caused the market price of Charter stock, which had been over $16 per share at the beginning of 2002, to plummet over 20% to $13 per share by January 18, 2002. (These growth rates, while reduced, were still artificially buoyed by Charter's "hold disconnects" practices detailed in ¶¶ 49 to 59, *supra*.)

134. On February 11, 2002, Charter continued to mislead investors when it announced its 2001 year-end results in a press release, which stated in part:

> **Charter 2001 Pro Forma Cable Modem and Digital Customers Increase Nearly 165% and 82%, Respectively**
>
> ST. LOUIS – Charter Communications, Inc. (Nasdaq: CHTR) today reported revenue growth that exceeded its guidance, and cash flow growth at the top of its estimated range for the year 2001. These results were highlighted by the addition of a near record number of new cable modem customers during the fourth quarter.
>
> . . . .
>
> As of December 31, 2001, Charter Digital Cable™ customers totaled 2,144,800 with fourth quarter weekly additions averaging approximately 15,000 installations per week. "Charter continues to experience strong demand for its digital video service, resulting in industry leading penetration. As we continue to add interactive products like video on demand (VOD), and personal interactive channels, we see enhanced

> customer satisfaction, reduced digital churn, and improved retention levels," Mr. Vogel said.
>
> . . . .
>
> Fourth Quarter Financial Highlights
>
> Revenue during the fourth quarter of 2001 increased 13.6% to $1.1 billion, and operating cash flow increased 11.0% to $502.6 million compared to pro forma results for the fourth quarter of 2000, before a special charge including the @Home conversion of $17.6 million. Year-end 2001 pro forma revenue was over $4.1 billion, up 14.0% from pro forma 2000 revenue of $3.6 billion. Pro forma operating cash flow increased 10.9% from $1.65 billion to $1.83 billion for 2001, before a special charge including the @Home conversion of $17.6 million.

135. In connection with the announcement of these year-end results, Charter hinted for the first time that its customer base had been materially inflated. However, it did so in a misleading manner so as to avoid any critical examination of its prior representations. The Company stated that it expected to remove approximately 120,000 "marginal customers" from its basic customer account in the first quarter of 2002, and that it had increased its reserves for uncollected accounts receivable as of December 31, 2001. This write-off represented two years of the company's basic customer subscriber growth.

136. The foregoing 4Q01 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*. In addition:

a. The reasons given for the write-off of customers was false and misleading. The Company sought to give

the impression that it was taking an initiative to make its customer base even stronger by eliminating those that may have paid their bills, but were "marginal" and thus not profitable. Indeed, as an analyst at Banc of America Securities characterized it, Charter had merely decided to "disconnect unprofitable subscribers." (April 29, 2002 report.)

b. In fact, the Company was now doing what it should have done long before, i.e., write-off customers who had themselves sought to terminate their accounts. The statement was designed and intended to deflect attention from the fact that Charter's internal customer growth rate had been materially smaller than represented. In fact, the write-off of these customers was needed because the Company had been holding disconnects of well over 100,000 customers cumulatively during the Class Period.

c. Moreover, the Company failed to disclose the full extent of its potential write-off. At the same time Charter wrote-off 120,000 customers, it created a "reserve" for disconnecting 45,000 additional customers.

137. On March 29, 2002, Charter filed its Form 10-K for the year-end 2001 with the SEC. The Form 10-K repeated the same financial information that was announced in the press release of February 11, 2002, referenced *supra*, and was signed by defendants Allen, Vogel and Kalkwarf. The Company raised the number of customers written off to 145,000 (from the previously announced 120,000). It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

138. In its "Report of Independent Public Accountants," defendant Arthur Andersen gave the following

unqualified opinion on Charter's financial statements contained in its 2001 For 10-K:

> In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Charter Communications, Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

139. This was false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

140. Defendants continued to mislead investors in a press release dated April 29, 2002;

> **Charter Posts Strong Revenue and Cash Flow Growth For the First Quarter of 2002**
>
> Strategic marketing and bundling of services drives first quarter 2002 revenue and operating cash flow growth
>
> ST. LOUIS – Charter Communications, Inc. (Nasdaq: CHTR) exceeded expectations for revenue and cash flow growth during the first quarter of 2002.
>
> First Quarter Financial Highlights
>
> Revenue during the first quarter of 2002 increased 13.1% to $1.1 billion, and operating cash flow increased 10.4% to $449.2 million compared to pro forma results for the first quarter of 2001. "Our revenue and cash flow for the quarter exceeded the high end of our expectations and will

> provide a solid base of growth which we expect to accelerate throughout the year," Mr. Vogel said. Charter reported basic and diluted loss per share of $39 for the first quarter of 2002, compared to a loss per share of $1.20 for the first quarter of 2001.

141. The foregoing 1Q02 results were materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

142. By this time though, even upbeat analysts were beginning to acknowledge that the decline in the Company's stock price (to a closing price of $7.79 per share on May 13, 2002), was attributable to growing investor skepticism triggered by the February write-off of customers. As a Credit Suisse analyst commented in a report dated May 14, 2002:

> The Company recently announced it would have to write down 120,000 basic video subscribers due to nonpayment, which represent 2 years of subscriber growth and a significant credibility issue with investors.

143. On May 14, 2002, Charter filed its Form 10-Q for the first quarter of 2002 with the SEC. The Form 10-Q repeated the same financial information that was announced in the press release of April 29, 2002, referenced *supra*. The Form 10-Q was signed by defendants Kalkwarf and Martin. It was materially false and misleading for the reasons set forth in ¶ 95(a)-(e), *supra*.

144. The market price of Charter stock continued to descend as investors, aware of the unraveling fraud at Adelphia, were concerned that the same thing might have occurred at Charter as well. By June 13, 2002, Charter's

stock price had sunk to $4.48 per share. At this point, one of the company's boosters, Morgan Stanley, came to the Company's defense in an analyst report dated June 14, 2002, seeking to assure investors that Charter was not another Adelphia. The report was written after further communication with Charter management, including defendants Barford and Kalkwarf:

> We believe that Charter does not represent a risk for accounting inconsistencies or revisions to prior financial performance. Since its public offering in late 1999, Charter has remained consistent with respect to how it recognizes revenue, capitalizes labor, and depreciates its network. We believe that the panic selling that has occurred over the last few months as the Adelphia situation has unraveled, represents a buying opportunity . . . .
>
> We estimate that Charter capitalizes about $325-350 million of installation and engineering labor costs each year. These estimates are within the range for the group, but not at the lower end of the range for the industry . . . *It is very important to recognize that Charter has consistently applied its capitalization policies and has not made accounting changes that might have distorted revenue and EBITDA growth rates.*
>
> [Emphasis Supplied].

145. The foregoing statements by Morgan Stanley, which helped boost the price of Charter stock by over 20% in one day, were indicative of the degree to which defendants had misled investors, since, contrary to the analyst's conclusions, Charter had indeed consistently capitalized labor charges that it knew, even under its own policies, should have been expensed.

Revelations

146. On July 18, 2002, one day after the end of the Class Period, Merrill Lynch published a Comment concerning Charter by analyst Jessica Reif Cohen ("Cohen") entitled "Q2E: Basic Sub Losses Continue and Accounting Worries Not Over; Downgrade to Neutral;"

> We are reducing our intermediate term investment rating to Neutral from Strong Buy due to Charter's high leverage, lack of positive free cash flow generating for at least 18 months and continued accounting worries in general for the sector. Additionally, investors remain averse to highly leveraged companies with no earnings and no free cash flow, i.e. companies with EBITDA-based valuations.
>
> . . . .
>
> Accounting Practices
>
> We believe that Charter's upcoming June 10Q filing will include more detail about its accounting practices, including subscriber count calculations and marketing deals with equipment vendors. Further, Charter plans to offer more clarity in its capital expenditures and debt covenants. While we applaud Charter's decision, the release of more detail could be a double-edged sword. While investors are likely to appreciate the more detailed filing, since they have been clamoring for more transparency, investors might not be reassured by what they uncover.
>
> While accounting practices are relatively similar across the industry, there are some differences across cable operators. We believe that Charter has a more aggressive capitalization policy, evidenced by its top-of-the-industry EBITDA

> margins and also its high capex spending per basic subscriber (although some of that is partially due to Charter's lower densities). Further Charter includes some of its programming launch fees in cable advertising revenue (similar to AOL but unlike Cox, Comcast and Cablevision). This is actually significant and consisted of roughly one third ($100 million) of total CY01 advertising revenue at essentially 100% EBITDA margins. In addition, we understand that Charter allocates the $10/month incremental revenue from its data-only subscribers (data-only subs. are typically charged an additional $10 for not taking a bundle of data+video) to basic cable revenue and hence includes the subscriber in the basic cable subscriber count. While we believe this is a very insignificant number, the mere fact that Charter is taking such an aggressive stance could lead investors to question all its practices. Moreover, we understand that Charter has done some marketing deals with equipment vendors (as does Comcast).

147. The partial disclosure of Charter's improper accounting practices, as described in Cohen's July 18, 2002 Comment, had an immediate and sharply negative effect on Charter's stock price. On that day, Charter's stock dropped more than thirteen percent (13%), falling from the previous day's close of $4.06 per share, to close of $3.50 per share on July 19, 2002.

148. Indeed, Charter's use of misleading accounting practices to artificially inflate its revenue and earnings was further detailed in the August 12, 2002, issue of *Forbes*, which quoted a July 12, 2002, report by Credit Suisse First Boston concerning the cable industry. The *Forbes* article stated in pertinent part:

> The [Credit Suisse] report provides a detailed look at "churn," which is essentially cable's costs for labor and advertising. Credit Suisse says that cable companies have been hiding the impact of their churn by capitalizing labor costs. In other words, if they spend $50 to install cable in a home, the cable guys only subtract $20 from revenues to calculate the current period's earnings. Then they spread the rest over a dozen years. The worst offender, Credit Suisse says, is Charter Communications, which capitalizes $29 per customer.

149. On August 16, 2002, Charter acknowledged that it had received a subpoena for documents from a federal grand jury that was conducting a criminal investigation of "the Company's current and disconnected customers, and its policies and procedures related to the capitalization or expense of various costs and related matters." The Company further admitted that the investigation probably related in part to the matters raised by the CSFB and Merrill Lynch analyst reports. The investigation also followed on the heels of the Company's announcement that it was increasing its reserves to account for its decision to disconnect 145,000 "marginal" customers.

150. On October 22, 2002, Charter announced that it was placing its COO, defendant Barford, on paid leave, pending the previously announced Grand Jury investigation.

151. On December 3, 2002, the Company announced that defendant William Shreffler, who was then Senior Vice President of Operations for the Midwest Division, resigned his position, "citing personal reasons."

152. On December 23, 2002, Charter announced that it was firing defendants Barford and Kalkwarf, and reauditing its books for 2000 and 2001. "The terminations of Messrs. Barford and Kalkwarf follow a review by the Company of various matters, including those related to the Grand Jury investigation," a Company spokesman said.

153. As a result of these revelations, Charter's shares dropped to a 52-week low of $0.78 on October 11, 2002, down approximately 97% from its Class Period high of $26.31.

154. On April 1, 2003, Charter announced the "preliminary results" of the reaudit for years 2000 and 2001. As a result of the reaudit, the following major restatements were made:

	2001 ($ millions)	2000 ($ millions)
Revenue Reduced by:	$146	$108
Expenses Increased by:	$146	$87
EBITDA Reduced by:	$292	$195

155. The Company acknowledged that as a result of the foregoing, its pro forma adjusted EBITDA for 2001, which had previously been reported as $1.8 billion, was restated to only $1.543 billion. Similarly, whereas reported pro forma adjusted EBITDA for 2000 had been previously reported as $1.6 billion, it was restated to only $1.454 billion. Thus, in contrast to the previously reported EBITDA growth rate between 2001 and 2000 of 12.5%, the actual growth rate was only 6%.

156. There were further materially adverse adjustments announced for the first 3 quarters of 2002, though

there was no indication of the portion of those adjustments that related only to the first quarter of 2002.

157. The April 1, 2003 press release also stated:

> **(a) Launch Incentives From Programmers.**
>
> Amounts previously recognized as advertising revenue in connection with the launch of new programming channels have been deferred in the year such launch support was provided, and amortized as a reduction of programming costs based upon the relevant contract term. Such adjustments decreased revenue $30 million for the first three quarters of 2002, and $118 million and $76 million for the years ending December 31, 2001 and 2000, respectively. Additionally, for the year ending December 31, 2000, the company increased marketing expense by $24 million for other promotional activities associated with launching new programming services previously deferred and subsequently amortized. The corresponding amortization of such deferred revenues reduced programming expenses by $36 million for the first three quarters of 2002, and $27 million and $5 million for the years ending December 31, 2001 and 2000, respectively.
>
> **(b) Capitalized Labor and Overhead Costs.**
>
> Certain elements of labor costs and related overhead allocations previously capitalized as part of the Company's rebuild activities, customer installation and new service introductions have been expensed in the period incurred. Such adjustments increased operating expenses by $73 million for the first three quarters of 2002, and $93 million and $52 million for the years ending December 31, 2001 and 2000, respectively.

(c) **Customer Acquisition Costs.**

Certain customer acquisition campaigns were conducted through third party contractors in 2000, 2001 and portions of 2002. The costs of these campaigns were originally deferred and recognized as amortization expense over the relevant customer contract terms. These amounts have been reported as marketing expense in the period incurred and totaled $32 million for the first three quarters of 2002, and $59 million and $4 million and for the years ending December 31, 2001 and 2000, respectively. The company determined in the second quarter of 2002 that the benefits of this program did not justify its continued practice and it was eliminated in the end of the third quarter as contracts for third party vendors expired.

158. In response to these disclosures, Deutsche Bank Securities, Inc., issued analyst reports noting that Charter's "adjustments" of $487 million to previously reported EBITDA represented "*significant* reductions relative to the restated pro forma totals. . . ." [Emphasis Supplied]. A. G. Edwards issued a similar report stating "we believe that the breadth of these restatements are significant. . . ."

159. The Company also disclosed for the first time that there had been "45,000 accounts that were reserved at year end 2001 to address pending disconnects." This was in addition to the 120,000 customers the Company had announced it would be writing off at the time. (In fact, the Company wrote-off an additional 25,000 customers by July 2002, and had no "reserve" for customer disconnects at year end 2002.)

160. With respect to the ongoing Grand Jury investigation, Charter stated:

> The adequacy of the 45,000 customer reserve, the disconnect policies, the application of those policies and their effect on the customer totals reported by the Company during 2001 and prior periods are currently under investigation by the United States Attorney's Office for the Eastern District of Missouri and the Securities and Exchange Commission.

161. Finally, the Company acknowledged that these restated results were "preliminary" and that it had filed for an extension "to provide additional time to finalize its financial statements, related filings, disclosures and audits."

The Indictment and Guilty Plea

162. On July 24, 2003, the Grand Jury returned an Indictment charging that:

> Beginning in or about May 2001 and continuing through in or about March 2002, Barford, Kalkwarf, McCall and Smith knowingly devised and intended to devise a scheme to defraud investors in Charter securities and the investing public . . . by falsely inflating Charter's subscriber numbers and subscriber growth numbers and by making false statements relating to Charter's subscriber numbers and subscriber growth numbers, in order to inflate artificially Charter's stock price . . . . (Indictment ¶ 44).

163. The Indictment further charged that:

> Beginning in or about August 2000, and continuing through on or about February 11, 2001, Kalkwarf and Barford knowingly devised and intended to devise a scheme to defraud investors in

> Charter securities . . . by falsely inflating Charter's publicly reported year end revenue and operating cash flow and by making false statements relating to the inflated revenue and operating cash flow, in order to inflate artificially Charters' stock price. . . . (Indictment ¶ 17).

164. In his guilty plea entered the next day, on July 25, 2003, defendant McCall admitted that:

> From in or about June of 2001 and continuing until in or about March of 2002 . . . David McCall did knowingly and willfully participate in a scheme to defraud Charter's stockholders by means of materially false and fraudulent pretenses, presentations and promises. (Guilty Plea at 9)

165. That same day, at a hearing before the Honorable Carol Jackson, defendant McCall stated:

> I was instructed to meet certain quarterly expectations, in terms of company expectations for how many customers you gained on a quarterly basis. Did that. And instructed people that worked for me to do that and knowing that, you know, that those numbers would in turn be used to meet forecasts that would be done in a public – to the public environment like Wall Street. (Transcript at 16-17)

CLASS ACTION ALLEGATIONS

166. Lead Plaintiff brings this action as a class action pursuant to Rules 23(a) and 23(b)(3) of the Federal Rules of Civil Procedure, individually and on behalf of all persons or entities who purchased or acquired Charter common stock during the Class Period and were damaged

thereby, excluding the Defendants herein, their affiliates and any officers or directors of Charter or its affiliates, and any members of their immediate families and their heirs, successors and assigns (the Class).

167. The Class is so numerous that joinder of all the members of the Class is impracticable. Lead Plaintiff believes there are hundreds of record holders of the Company's common stock located throughout the United States.

168. Lead Plaintiff's claims are typical of the claims of absent Class members. Members of the Class have sustained damages arising out of Defendants' wrongful conduct in violation of the federal securities laws in the same way as Plaintiff sustained damages from the unlawful conduct.

169. Lead Plaintiff will fairly and adequately protect the interests of the Class. Lead Plaintiff has retained counsel competent and experienced in class action and securities litigation.

170. A class action is superior to other available methods for the fair and efficient adjudication of the controversy. The Class is numerous and geographically dispersed. It would be impracticable for each member of the Class to bring a separate action. The individual damages of any member of the Class may be relatively small when measured against the potential costs of bringing this action, and thus make the expense and burden of this litigation unjustifiable for individual actions. In this class action, the Court can determine the rights of all members of the Class with judicial economy. Lead Plaintiff does not anticipate any difficulty in the management of this suit as a class action.

171. Common questions of law and fact exist as to all members of the Class and pre-dominate over any questions affecting solely individual members of the Class. These questions include, but are not limited to, the following:

a. whether defendants' conduct as alleged herein violated the federal securities laws;

b. whether the SEC filings, press releases and statements disseminated to the investing public during the Class Period misrepresented Charter's financial condition and results;

c. whether defendants acted knowingly or with deliberate recklessness in omitting and/or misrepresenting material facts;

d. whether the market price of Charter common stock during the Class Period was artificially inflated; and

e. whether the members of the Class have been damaged, and if so, what is the proper measure of damages.

172. Lead Plaintiff will rely, in part, upon the presumption of reliance established by the fraud-on-the-market doctrine in that:

a. defendants made public misrepresentations or failed to disclose material facts during the Class Period;

b. the omissions and misrepresentations were material;

c. the stock of the Company traded on the Nasdaq, an efficient market;

d. the market reacted to public information disseminated by the Company, and the Company was followed and reported on by various securities analysts;

e. the misrepresentations alleged would tend to induce a reasonable investor to misjudge the value of the Company's securities; and,

f. Lead Plaintiff and the members of the Class purchased their Company stock between the time the defendants or misrepresented material facts and the time the true facts were disclosed, without knowledge of the misrepresented facts.

COUNT I

VIOLATIONS OF §§ 11, 12 and 15 OF THE SECURITIES ACT AGAINST ALL CHARTER RELATED DEFENDANTS OTHER THAN VOGEL

173. Lead Plaintiff repeats and re-alleges, as if fully set forth herein, those paragraphs regarding the initial public offering of Charter stock; the false and misleading statements made in connection therewith; and the reasons why those statements were false and misleading, *i.e.*, ¶¶ 95-97, *supra*. This claim does not sound in fraud, and neither fraud nor scienter is an element of this claim. None of the paragraphs regarding defendants' scienter are incorporated herein.

174. This claim is brought by Lead Plaintiff on behalf of all persons who purchased shares of Charter stock pursuant to the IPO Registration Statement Lead Plaintiff and other Class members acquired their shares pursuant to or traceable to the Registration Statement.

175. Defendants (other than Vogel, Scientific-Atlanta and Arthur Andersen) issued and disseminated, caused to be issued and disseminated, and participated in the issuance and dissemination of, materially false and misleading written statements to the investing public which were contained in the Registration Statement, which misrepresented or failed to disclose, *inter alia*, the facts set forth above in ¶ 95(a)-(e), *supra*. Charter issued the Prospectus and Registration Statement that accompanied the IPO. Each of the Individual Defendants (other than Vogel) was an officer, director, or controlling person of Charter at the time of the IPO.

176. As a direct and proximate result of defendants' acts and omissions in violation of the Securities Act, the market price of Charter stock was artificially inflated in the IPO, and Lead Plaintiff and the Class suffered substantial damage in connection with their purchase of Charter common stock pursuant to the Registration Statement and Prospectus.

177. At the times they purchased their shares in the IPO, Lead Plaintiff and members of the Class who purchased such shares were without knowledge of the facts concerning the false or misleading statements or omissions alleged herein.

178. Less than two years elapsed from the time that the events upon which this action is based, to the time that this action was filed. Less than five years elapsed from the time that the securities upon which this claim is brought were offered to the public to the time this action was commenced.

COUNT II

VIOLATIONS OF § 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER AGAINST ALL CHARTER RELATED DEFENDANTS

179. Lead Plaintiff repeats and realleges each and every allegation contained in the paragraphs above as if fully set forth herein.

180. At all relevant times, the Charter Related Defendants, individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct whereby they knowingly and/or with deliberate recklessness made and/or failed to correct public representations which were or had become materially false and misleading regarding Charter's financial results and operations as set forth in ¶¶ 96-136, *supra*. These statements were materially false and misleading for reasons stated in ¶ 95(a)-(e), *supra*.

181. Defendant Charter was a direct participant in the wrongs complained of herein. The Individual Defendants are liable for the wrongs complained of herein as direct participants in and controlling persons of the Company. By virtue of their positions of control and authority as officers, directors and controlling shareholder of Charter, the Individual Defendants were able to and did, directly or indirectly, control the preparation, issuance and/or content of the aforesaid public statements relating to the Company. Portrait photographs of each of the Individual Defendants were included in Charter's 2000 or 2001 Annual Reports. Each of the Individual Defendants participated in making the false and misleading statements under the group publication doctrine.

182. The Charter Related Defendants had actual knowledge of the facts making the material, statements false and misleading, or deliberately acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though same were available to them as set forth in ¶¶ 83-94, *supra*. In addition:

a. As officers, directors and/or controlling persons of a publicly held company whose common stock is registered with the SEC under the Exchange Act and traded on the Nasdaq, the Individual Defendants had a duty to promptly disseminate accurate and truthful information with respect to the Company's operations, finances, financial conditions, and present and future business prospects, to correct any previously issued statement from any source that had become untrue, and to disclose any trends that would materially affect earnings and the present and future operating results of Charter, so that the market price of the Company's publicly traded securities would be based upon truthful and accurate information.

b. During the Class Period, the Individual Defendants were senior executives and directors of Charter and were privy to confidential and proprietary information concerning Charter, its operations, finances, financial condition, products, and present and future business prospects via internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and Board of Directors meetings and committees thereof, and via reports and other information provided to them in connection therewith.

183. In ignorance of the adverse facts concerning Charter's business operations and earnings, and in reliance on the integrity of the market, Lead Plaintiff and the members of the Class acquired Charter common stock at artificially inflated prices and were damaged thereby.

184. Had Lead Plaintiff and the members of the Class known of the materially adverse information not disclosed by the Charter Related Defendants, they would not have purchased Charter common stock at all, or not at the inflated prices paid.

185. By virtue of the foregoing, the Charter Related Defendants have violated Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder.

COUNT III

VIOLATION OF § 20(a) OF THE EXCHANGE ACT AGAINST THE INDIVIDUAL DEFENDANTS

186. Lead Plaintiff repeats and realleges each and every allegation contained in the paragraphs above as if fully set forth herein.

187. This count is asserted against the Individual Defendants and is based upon Section 20(a) of the 1934 Act.

188. The Individual Defendants, by virtue of their offices, directorships, stock ownership and specific acts were, at the time of the wrongs alleged herein and as set forth in Count II, controlling persons of Charter within the meaning of Section 20(a) of the 1934 Act. The Individual Defendants had the power and influence and exercised the same to cause Charter to engage in the illegal conduct and

practices complained of herein by causing the Company to disseminate the false and misleading information referred to above. Moreover, during the Class Period, the defendant Allen controlled a majority of the Company's stock.

189. By virtue of the conduct alleged in Count II, the Individual Defendants are liable for the aforesaid wrongful conduct and are liable to Lead Plaintiff and the Class for damages suffered.

COUNT IV

VIOLATIONS OF § 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER AGAINST ARTHUR ANDERSEN

190. Lead Plaintiff incorporates by reference all of the foregoing paragraphs as if realleged herein.

191. Defendant Arthur Andersen served as Charter's independent auditors throughout the Class Period. In that capacity, it performed audits of Charter's books, records, and financial statements for the years 1999, 2000, and 2001. Following such audits, Arthur Andersen issued opinion letters stating that its audits of Charter's financial statements had been conducted in conformance with Generally Accepted Auditing Standards, and that statements conformed with GAAP.

192. Such statements were false and misleading, for reasons set forth in ¶ 95(a)-(e), *supra*. As set forth in ¶¶ 153-157, *supra*, annual reports for 2000 and 2001 have been restated.

193. As Charter's auditor, Arthur Andersen had full access to its books, records and personnel, and knew, or recklessly disregarded, *inter alia*, the facts that:

a. The Company's capitalization rate was the highest in the industry, and resulted from the Company's improper capitalization of costs that clearly should have been expensed;

b. The Company's had a pattern of holding disconnects, which contributed to a significant rise in account receivables that should have been promptly written off; and,

c. The Company improperly accounted for other matters, such as including all launch fees paid by program providers at the initial date of a contact, rather than over the entire term of the contract.

d. Though aware that Charter was seeking to boost its revenues by paying vendors higher prices at the same time it received additional advertising from the same vendors, Andersen failed to properly audit these transaction by confirming them with the vendors.

194. Defendant Arthur Andersen thereby violated § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT V

VIOLATIONS OF § 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER AGAINST SCIENTIFIC-ATLANTA AND MOTOROLA

195. Lead Plaintiff incorporates by reference all of the foregoing paragraphs as if realleged herein.

196. As detailed above, defendants Scientific-Atlanta and Motorola engaged in a series of sham transactions whereby it agreed to return to Charter monies paid for

additional charges paid for converter boxes and other cable related devices. Such monies were returned in the form of "advertising." Scientific-Atlanta and Motorola agreed to such sham transactions knowing or recklessly disregarding that Charter intended to inflate its reported results by recording the monies it received as revenues, while recording monies it paid to Scientific-Atlanta as capital expenses. Scientific Atlanta and Motorola also knew that analysts would be relying upon such reported amounts in making their recommendations regarding Charter's stock.

197. By virtue of such misconduct, Scientific-Atlanta and Motorola made materially misleading statements to Charter investors knowing or recklessly disregarding that such statements were false and misleading, and thereby violated § 10(b) of the Exchange Act and Rule 10b-5(b) promulgated thereunder, as set forth in ¶ 95(a)-(e), *supra*.

198. Alternatively, these sham transactions constituted a "device, scheme or artifice to defraud" and "an act, practice or course of business which operate[d] . . . as a fraud or deceit" upon Charter investors, in violation of Rule 10b-5(a) and (c), for which Scientific-Atlanta and Motorola are likewise liable.

PRAYER FOR RELIEF

WHEREFORE, Lead Plaintiff demands judgment:

a. Determining that the instant action is a proper class action maintainable under Rule 23 of the Federal Rules of Civil Procedure;

b. Awarding compensatory damages and/or rescission as appropriate against defendants, in favor of Lead

Plaintiff and all members of the Class for damages sustained as a result of defendants' wrongdoing;

c. Awarding Lead Plaintiff and members of the Class the costs and disbursements of this suit, including reasonable attorneys', accountants' and experts' fees; and

d. Awarding such other and further relief as the Court may deem just and proper.

JURY DEMAND

Lead Plaintiff hereby demands a trial by jury.

Dated: August 4, 2003

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